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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, ~~1929~~ 1930

DAVID BURNET

No. ~~579~~ 31

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SANFORD & BROOKS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED JANUARY 16, 1930
CERTIORARI GRANTED MARCH 3, 1930

(34710)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 579

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SANFORD & BROOKS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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1 Before United States Board of Tax Appeals

For the taxpayer: Harry N. Baetjer, Esq. For the Comm'r: M. N. Fisher, Esq.

SANFORD & BROOKS COMPANY, SOUTH & WATER STS., BALTIMORE, MD., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

1926

Jan. 16—Petition received and filed.
" 20—Copy of petition served on Solicitor.
" 20—Notification of receipt mailed taxpayer.
Feb. 23—Answer filed by Solicitor.
Mar. 18—Copy of answer served on taxpayer. Assigned to General Calendar.

1927

May 5—Hearing had before Mr. Green on merits.
Mar. 16—Hearing date set May 5, 1927.
Briefs due Aug. 1, 1927.
" 23—Transcript of hearing May 5, 1927, filed.
June 29—Memorandum filed by G. C.
July 30—Brief filed by taxpayer.

1928

Apr. 9—Findings of fact and opinion rendered. Judgment will be entered for the respondent.
" 10—Order of redetermination entered.
Oct. 4—Supersedeas bond for $100,000 approved and ordered filed.
" 4—Petition for review by United States Circuit Court of Appeals, Fourth Circuit, with assignments of error filed by taxpayer with proof of service thereon.
2 Dec. 1—Praecipe with proof of service thereon filed by taxpayer.
Dec. 1—Statement of evidence lodged by taxpayer.
" 1—Motion for extension to December 31, 1928, for preparation and transmission of record filed by taxpayer.
" 3—Amended praecipe with proof of service thereon filed by taxpayer.
" 3—Order enlarging time to December 31, 1928, for filing certified copies of record papers sur petition for review entered.

Now, December 19, 1928, the foregoing docket entries certified from the record as a true copy.

(SEAL)

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

APPEAL OF SANFORD AND BROOKS COMPANY, a corporation, South and Water Streets (formerly 24 Commerce St.), Baltimore, Md.	Docket No. 11021.

Petition

Filed January 16, 1926

The petition to the United States Board of Tax Appeals by the Sanford and Brooks Company, a corporation, respectfully shows:

1. The petitioner, the taxpayer, is a Delaware corporation with its principal office at the corner of South and Water Streets (formerly 24 Commerce Street), Baltimore, Maryland.

2. Under date the 22nd day of June, 1925, the taxpayer was advised by the Commissioner of Internal Revenue under symbols IT:E:SM, RCH–B–19368, C–23285, that he had found income and profits taxes to be due by it for the year 1919 in the amount of
3 $3,818.15 and for the year 1920 in the amount of $50,883.90, a total deficiency in tax of $54,702.05. An appeal was taken from this ruling, hearing was granted on the 15th of September, 1925, or thereabouts, and under date November 17th, 1925, the taxpayer was advised that the conclusions of the department set out in its letter of June 22nd, 1925, showing a deficiency in tax in the amount of $54,702.05, as aforesaid, had been sustained; from this decision an appeal is taken to this Honorable Board. There is attached hereto, as a part hereof, a copy of the letter of November 17th to the taxpayer from the Commissioner of Internal Revenue and of the statement attached to said letter.

3. The claimed deficiency is in income and profit taxes. The amount which is asserted is $3,818.15 for the year 1919, and $50,883.90 for the year 1920, a total of $54,702.05, which is the amount in controversy.

4. The single assignment of error which the taxpayer alleges has been made is this:

In the year 1913, 1914, 1915, and 1916 the taxpayer, as agent for the Atlantic Dredging Company, was engaged in making excavations in the Delaware River, under a contract with the United States. In these years it lost on this contract $176,291.88, allocated as between those years as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89

These losses were operating losses, that is to say, the expenses incident to making the excavations exceeded the contract price for doing the work. Until after 1916 the taxpayer assumed the losses

had been made on account of its having taken an unprofitable contract. Subsequent to 1916, however, the taxpayer was told that certain representations made on behalf of the Federal Government, on the strength of which the contract was entered into, were false and misleading. It promptly discontinued the work and sued the United States in the Court of Claims on account of the
4 expenditure and loss made by it in the performance of the contract.

The Court of Claims in an opinion by Judge Hay, found that the loss sustained by the taxpayer was $211,050.59, which it allowed the claimant. On appeal to the Supreme Court of the United States the judgment of the Court of Claims was affirmed, and there was accordingly paid in 1920 to the taxpayer the amount of the judgment, with interest thereon of $16,305.71, a total of $227,355.80. The Atlantic Dredging Company was entitled to and there was paid to it $34,758.21, making the net amount received $192,579.59.

The interest allowed, $16,305.71, would under any circumstances be taxable income for the year 1920 in which it was received; deducting this sum from the amount received as aforesaid, after paying the Atlantic Dredging Company its pro rata share, left a balance of $176,273.88 (erroneously stated in the letter from the department of November 17th, 1925, as $148,207.16), the amount of which balance the taxpayer insists is taxable for the years 1913, 1914, 1915, and 1916, and so reported in its amended returns filed after receipt of the money. The Government has contended that this sum constitutes income for the year in which received, viz, 1920; it has so held, and the claimed deficiency in tax results from this holding.

5. The facts upon which the position of the taxpayer is grounded are these: The loss which was ultimately made good by the Government in accordance with the decision of the Supreme Court of the United States was sustained by the taxpayer in the years 1913, 1914, 1915, and 1916; the total loss was $176,291.88 and was allocated to the four years aforesaid in the following amounts, viz:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89

These losses represented the cost of doing the work under the contract in excess of the amount paid for the work by the Government. The losses were sustained on account of the improper
5 withholding by the Government of information in its possession and which it failed to disclose to the taxpayer before it made its bid to do the dredging. As soon as the taxpayer learned of the facts which were known to the Government, but which had not been disclosed to it, it discontinued the work and instituted suit to recover the amount of its losses. The Court of Claims allowed it only its actual losses, with interest, so that the recovery

from the Government represents no profit but is simply a return to it of monies which it had expended for the account of the Federal Government induced thereto by the withholding of facts known to the Federal Government and not disclosed to it but improperly withheld from it. The decision of the Court of Claims was affirmed by the Supreme Court of the United States, the decision being reported in the reports of the Supreme Court, Vol. 253, at page 1.

6. The propositions of law involved in the appeal are three, viz:

(a) That the money recovered from the Federal Government is not properly income or profits subject to tax.

(b) That if it is taxable at all, it can be taxed only for the years in which it was earned.

(c) That the entire amount received should be added to the invested capital of the taxpayer for the years 1917, 1918, and 1919, and the invested capital correspondingly increased, with a resulting increase in the amount of earnings, exempt from tax.

In addition to the above a fourth question of law is also presented, viz, if the amount paid to the taxpayer is credited to the years in which the loss was sustained which is reimbursed by the payment, it will result in there being added to the invested capital of the taxpayer for the years 1917, 1918, 1919, and 1920 an amount equal to the amount of the payment, viz: $176,273.88, its invested capital being increased in each of said years by that amount. As a result of this addition to its invested capital, the taxpayer will be entitled to deduct from its earnings before computing the tax thereon, in addition to the amount heretofore deducted by it in its return an amount equal to the allowed percentage on the amount so paid to it. This will result in a sum due to the taxpayer of $4,484.08, as shown by its amended returns.

6

The taxpayer, of course, admits that it can not both collect the money as it has done and contend that it is a return to it of monies improperly expended for the account of the Federal Government and yet get the benefit of the failure of the debtor to pay when due by decreasing its profit by the amount withheld; it can, however, be held liable only to make good the benefit which it got by the original withhholding of the money, namely, by readjusting its earnings for the years, 1913, 1914, 1915, and 1916, and by crediting in those years the losses on the dredging contract sustained in each one of them, respectively, to the extent that the amount of these losses were subsequently refunded. This it has done in its amended returns, filed after the recovery of the money paid to it by the Federal Government. The loss covered by the refund was in no sense a loss charged off, as these words are used in the United States Taxing Statutes; as so used, the words imply a charging off with knowledge of all surrounding circumstances, as a positive act on

the part of the taxpayer and not a loss simply reflected in its operations.

Wherefore the taxpayer respectfully prays that this board may hear and determine its appeal.

SANFORD AND BROOKS COMPANY,
By W. B. BROOKS, *President.*

Attest:

A. L. HART, *Secretary,*
South and Water Streets, Baltimore, Md.

HARRY N. BAETJER,
Counsel for taxpayer.

7 Duly sworn to by Walter B. Brooks. Jurat omitted in printing.

Exhibit to petition

TREASURY DEPARTMENT

WASHINGTON

OFFICE OF COMMISSIONER OF INTERNAL REVENUE

Address reply to
Commissioner of Internal Revenue
and refer to
IT:E:SM-60D
RCH-B-19368
C-23285.

NOV. 17, 1925.

SANFORD AND BROOKS COMPANY,
24 Commerce Street,
Baltimore, Maryland.

SIRS: An audit of your income and profits tax returns for the years 1919 and 1920 has resulted in the determination of a deficiency in tax amounting to $54,702.05, as set forth in bureau letter dated June 22, 1925.

8 In accordance with the provisions of section 274 of the revenue act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the corrections of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed agreement con-

senting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT: E: SM-60D, RCH-B-19368, C-23285. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR, *Commissioner.*

By (Signed) C. R. NASH,
Assistant to the Commissioner.

Inclosures:
Statements
Agreement—Form A

STATEMENT

IT: E: SM-60D
RCH-B-19368
C-23285

In re Sanford and Brooks Company, 24 Commerce Street, Baltimore, Maryland.

Year	Deficiency in tax
1919	$3,818.15
1920	50,883.90
Total	54,702.05

Reference is made to your protest without date against the action of the unit in holding that the amount of a judgment received in 1920 from the United States Government in the sum of $148,207.15 was income for that year instead of the year in which it was earned.

After a careful review of your protest and of all the evidence submitted in support of your contentions at a conference held in this office on September 15, 1925, you are advised that the bureau holds that the income from a judgment accrues to the taxpayer when a final determination has been made. In this case the final determination took place when the Supreme Court of the United States affirmed the judgment of the lower court.

Accordingly the conclusions set forth in bureau letter dated June 22, 1925, are sustained.

Now, December 19, 1928, the foregoing petition certified from the record as a true copy.

[SEAL]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed Feb. 23, 1926

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

10 (1) Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

(2) Denies that any error was made in the determination of the deficiency in tax set out in the letter of November 17, 1925.

(3) Avers that the profits tax for 1920 was determined under the provisions of sections 327 and 328 of the revenue act of 1918.

(4) Admits that the amount received by the taxpayer on account of the judgment rendered by the United States Supreme Court in 1920 was $176,273.88.

(5) Denies that the aforementioned sum is allocable to the years 1913 to 1916, inclusive.

(6) Denies that the losses in 1913 to 1916, inclusive, were sustained on account of the improper withholding by the Government of information in its possession.

(7) Admits that the taxpayer sustained losses in the years 1913 to 1916, but denies that the losses were in excess of the amount recovered.

(8) Admits that the taxpayer discontinued its work under the original contract and instituted suit.

(9) Admits that the Court of Claims allowed it to recover actual losses with interest and that the decision of the Court of Claims was affirmed by the Supreme Court of the United States.

(10) Denies, generally and specifically, each and every allegation in the taxpayer's petition contained not hereinbefore admitted, qualified, or denied.

PROPOSITIONS OF LAW

(1) The sum of $176,579.59 with interest thereon amounting to $16,305.71 was income to the taxpayer in the year 1920 and not in any prior year.

11 (2) The profits tax for the year 1920 having been determined under the provisions of section 328 of the revenue act of 1918 on account of an abnormality affecting income, should, in the event the taxpayer prevails before the board, be recomputed under the provisions of section 301 of the revenue act of 1918.

Wherefore, it is prayed that the taxpayer's appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:
M. N. FISHER,
Special Attorney,
Bureau of Internal Revenue.

Now, December 19, 1928, the foregoing answer certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Findings of fact and opinion

Petitioner entered into a contract with the United States for certain dredging work. The work was carried on from 1913 to 1916, during which time the expenditures made by petitioner under the contract exceeded the amount received. Petitioner brought suit in 1916 and recovered in 1920 an amount measured by the difference between the expenditures and receipts. The basis of the suit was misrepresentations by the Government representatives in the making of the contract. Recovery was allowed on the ground that
12 since there was misrepresentation the petitioner should be compensated for the work done. *Held*, that the amount of the judgment was income in 1920.

HARRY N. BAETJER, ESQ.,
For the petitioner.
M. N. FISHER, ESQ.,
For the respondent.

The commissioner determined deficiencies in income and profits tax for the years 1919 and 1920 in the respective amounts of $3,818.15 and $50,883.90. The principal issue is whether an amount received in 1920 under a decision of the Court of Claims, rendered in 1918 and affirmed by the Supreme Court in 1920, is taxable income, and, if taxable income, whether it is taxable in 1920 when received, or in 1913 to 1916, inclusive, when the transactions arose which gave rise to the judgment. The year 1919 is involved only in so far as invested capital for that year may be affected by a holding that the amount of the judgment was properly allocable as income from 1913 to 1916, inclusive.

FINDINGS OF FACT

The petitioner is a Delaware corporation with principal office in Baltimore, Maryland.

In 1912 the Atlantic Dredging Company entered into a contract with the United States Government to dredge a part of the Delaware River. During the years 1913, 1914, and 1915, the petitioner, as agent for the Atlantic Dredging Company, was engaged in carrying on the work under the contract. In December, 1915, after having operated at a loss under the contract to this time, the petitioner refused to proceed with the contract and subsequently, in 1916, brought suit in the Court of Claims against the United States to recover an amount of $545,121.72 in addition to the amount which had been paid it on the basis of the unit prices set out in the original contract and a supplemental contract later entered into. This suit was brought in the name of "Atlantic Dredging Company, W. E. Brooks, Agent."

The basis on which recovery was sought was the failure on the part of the United States to make a proper disclosure in its specification of the character of the material to be dredged.

13 June 3, 1918, the Court of Claims decided that the Atlantic Dredging Company was entitled to recover the sum of $211,050.09 and entered judgment for that amount. Atlantic Dredging Company v. United States, 53 Ct. Cls. 490.

Upon appeal to the Supreme Court of the United States, this judgment was affirmed in a decision rendered April 26, 1920. United States v. Atlantic Dredging Company, W. B. Brooks, Agent, 253 U. S. 1,

The amount of the judgment, $211,050.09, together with interest of $16,305.71, or a total of $227,355.80, was paid in 1920. Of this amount the Atlantic Dredging Company received $34,778.21, and the petitioner, $192,577.59. The latter amount included interest in the amount of $16,305.71, and left a balance of $176,271.88 which the petitioner received under the judgment on account of work which it had performed.

The petitioner actually expended in the prosecution of the work the sum of $354,009.19. Prior to the recovery under the judgment of the Court, petitioner had received from the Government on account of the work in question the sum of $142,959.10, making a difference between the amount expended and the amount received of $211,050.09, the amount recovered in the judgment. The part of this excess of expenditures over payments received, $176,271.88, which was applicable to the petitioner, related to the years 1913 to 1916 on the basis of the excess of expenditures over receipts in these years as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89
Total	$176,271.88

The United States did not at any time prior to 1920 admit or recognize any liability to petitioner in addition to the amount set forth in the contract, nor did petitioner have the claim which formed the basis of the judgment on its books as an asset on account of a debt due from the United States until payment was received in 1920.

14 The excess of expenditures made over payments received from the contract in question served to decrease the income reported for the years 1913 to 1916. These returns showed losses for 1913, 1915, and 1916, and net income for 1914.

The Commissioner held that the entire amount of the judgment was income in 1920, whereas the petitioner did not report any of it as income in 1920, but filed amended returns asking that it be treated as income in the years 1913 to 1916, inclusive.

OPINION

LITTLETON: The first question is whether the amount of the judgment constitutes income at any time. The petitioner, through its principal, the Atlantic Dredging Company, had a contract with the Government for the dredging of a part of the Delaware River. During 1913, 1914, and 1915, material was removed and payment made therefore on the unit basis set out in the contract and a supplemental contract later entered into. During these years, the petitioner experienced difficulty in carrying on its operations and the undertaking proved an unprofitable one, partly, at least, for the reason that the material to be dredged was found to be more difficult of removal than that set out in the specifications forming the basis of the contract. In December, 1915, petitioner refused to proceed with the contract and in 1916 brought suit in the Court of Claims to recover an additional amount under the contract, alleging misrepresentations on the part of the governmental contracting officers. The Court of Claims, in 1918, allowed recovery of the difference between the amount expended by petitioner in carrying on the work under the contract and the amount which had already been paid on account thereof. This judgment was affirmed by the Supreme Court in 1920, when it was paid. While it appears that the petitioner sought in this action to recover amounts for prospective profits, use of its plant, and certain overhead charges and office expense, the judgment limited the recovery to the difference between the amount expended in connection with work under the contract and the amount previously paid for the work done. In concluding its decision, the Court of Claims made the following statement which is indicative of the character of the payment:

But if the plaintiff had been induced to enter into the contract by representations as to the character of the material to be dredged, and upon which it was entitled to rely, and which turned out to be untrue, then at any stage of the work it had the right to stop work and to sue to recover for whatever amount might be justly due it *for the work which it had already performed.* (Italics ours.)

The Supreme Court, in affirming the decision of the Court of Claims, said:

The Government makes the point, however, that the implication of the case is that bad methods were used, and insists that the implication makes the action one for a tort, and not tenable against the United States. We can not assent. There is no intimation of bad faith against the officers of the Government, and the Court of Claims regarded the representation of the character of the material as the nature of a warranty; besides, *its judgment is in no way punitive. It is simply compensatory of the cost of the work, of which the Government got the benefit.* (Italics ours.)

At the outset, it should be noted that we are here concerned with whether the amount of this judgment is properly to be included in

petitioner's gross income, and not whether the judgment constitutes an amount of net income subject to tax. Section 233 (a) of the revenue act of 1918 provides in the case of a corporation that "gross income means the gross income as defined in section 213" with certain exceptions not here material. Section 213 (a) reads as follows:

"That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Su-
16 preme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vacations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period: but * * *" In view of the fact that the Court of Claims held that the amount paid was an amount "due it for the work which it had already performed" and in view of the statement of the Supreme Court that the judgment was "in no way punitive" but was "simply compensatory of the cost of the work of which the Government got the benefit", it is difficult to see how it can be said that the amount received was not a part of petitioner's gross income. The amount received was an amount due under the contract on account of services performed thereunder. The dredging business in which petitioner was engaged was a business carried on for profit and the amounts received by the petitioner in such business were regularly reported as a part of its gross income. The holdings of the Court of Claims and the Supreme Court negative the conclusion that this judgment was anything other than a payment to be made of the same kind and character as that which was paid from 1913 to 1916 on the unit basis provided in the contract. On the theory on which the judgment was given, the petitioner should have been paid more in the years when it was rendering the services than it was paid. Certainly, if these payments had then been made no one would seriously contend that the amounts so received were not to be considered as a part of petitoner's gross income. Under such circumstances, the petitioner would have been taxed on the difference between such gross
17 income and the allowable statutory deductions and credits. Does the fact that the petitioner did not receive the entire

amount of compensation under the contract until 1920, and that when received, it was merely in an amount equal to the expenditures which were made under the contract change its character and make of it something other than income? We think not. There is nothing in either the decision by the Court of Claims or the Supreme Court to indicate that the judgment was other than compensation for work performed, and certainly under the statute and the judicial determinations made, compensation for the work here in question constitutes income. That it was measured by the expenditures made does not change its character. Nor do we understand that the judgment was a reimbursement for the expenditures made in the sense that the Government was obligated to make such reimbursement under the contract. The petitioner made expenditures under the contract that were allowable deductions from gross income, and they were so deducted and allowed in the returns for the years from 1913 to 1916, inclusive. Apparently the petitioner had income from sources other than this contract against which the expenses that measure the amount of this judgment were applied. But the judgment does not cancel these deductions; they were deductible on their own account when made and are in no sense changed by the fact that a judgment is awarded in the petitioner's favor as compensation for work which is equal in amount to the expenditures. The expenditures are deductions from gross income to the extent provided under the statute and the compensation is a part of gross income that must be accounted for in accordance with an entirely separate statutory provision.

We think the case of Bowers v. Kerbaugh-Empire Co., 271 U. S. 170, to which our attention is directed by the petitioner, is not in point. There the court was dealing with liquidation of a liability for a smaller sum in dollars than the face amount of such liability, something which at best might be denominated negative income, whereas this proceeding deals with the receipt of money for work done, positive income.

This brings us to the second phase of the question, i. e., When is the income represented by the judgment to be reported for tax purposes? The commissioner treated the entire amount as income in 1920, when the Supreme Court affirmed the judgment of the Court of Claims, and the judgment was paid, whereas the petitioner contends that the amount should be allocated to the years 1913 to 1916, inclusive, on the basis that expenditures made exceeded the amounts received in those years. The record does not disclose whether the petitioner was on a cash or accrual basis, but regardless of the method used, the board is of the opinion that the judgment could not be properly reported as income prior to 1920. On the cash basis, it would, of course, be includable in gross income only for 1920, since it was then paid. With respect to the accrual basis, we find that under the revenue act of 1913

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income to be reported is that received during the year for which a return is being rendered as distinguished from the later acts where both the cash and accrual bases are recognized. Maryland Casualty Co. v. United States, 251 U. S. 342. But even the accrual basis would not aid the petitioner for any of the years for which it desires to have the judgment allocated for the reason that the conditions precedent to the accrual of this income did not then exist. In United States v. Yale & Towne Mfg. Co., 269 U. S. 422, the court, in passing on the question when a tax accrues, said that a tax will accrue, when all events have occurred "which fix the amount of tax and determine the liability of the taxpayer to pay it.". The same general principles are applicable whether we are determining the accrual of taxes or the accrual of items of income or expense. In this proceeding it could not have been said at the end of 1916 that there had been any determination of liability on the part of the Government to pay the compensation in question. There was not only a denial at this time of liability on the part of the Government for the payment of any of the amount which was eventually recovered, but also the fixing of the liability was not accomplished until appeal was had to the Supreme Court. As evidence of the fact that doubt existed as to the existence of an obligation on the part of the Government to pay, we find that when the decision was rendered by the Court of Claims, the decision was accompanied by a strong dissenting opinion on the part of the chief justice of that court and likewise the decision of the Supreme
19 Court was dissented from by the Chief Justice and an associate justice. In such circumstances, we fail to see how any basis for an accrual of this compensation could be said to exist at any time prior to the decision by the Supreme Court.

The argument of the petitioner that the compensation should be placed in the years when the expenditures were made might, if accepted, afford a more equitable solution to the question here presented, but the board is of the opinion that no statutory authority exists for such action. While the case of Bowers v. Kerbaugh-Empire Co., supra, lends some color to the theory that we may look at a longer period than one year for the purpose of determining whether in fact a gain was realized or loss sustained in a given transaction, yet, for reasons already stated, we are of the opinion that an entirely different situation was there presented than in this proceeding. Under our system of Federal taxation an accounting period of one year has been prescribed as the basis for reporting income for tax purposes, and each taxable period stands alone with items of income and deductions determined in the light of events and circumstances transporting within that year. Here expenditures were made in the years 1913 to 1916 that were taken and allowed as proper deductions in those years, and the income in question was neither received in these years nor did a basis exist on which to account for it until 1920. We could no more transfer the income from 1920 to the earlier years for the purpose of taxing it than we could transfer the expenses to

1920 for the purpose of there allowing them as deductions. Furthermore, the years 1913 to 1916, inclusive, are not on appeal to the board, and the board accordingly can not make a determination of tax liability with respect thereto.

Reviewed by the board.

Judgment will be entered for the respondent.

Dissenting opinion

TRUSSELL, dissenting: The record in this case establishes that during the years 1913, 1914, 1915, and 1916 the petitioner was engaged in a dredging enterprise for the United States, and that during those years it disbursed moneys necessary to carry on the dredging work and received other moneys in part compensation for such work; that during the four years named the petitioner disbursed $176,-
20 271.88 more than it received and thereby sustained an actual money loss of the said amount of $176,271.88. Thereafter, as a result of litigation prosecuted through the Court of Claims and the U. S. Supreme Court, petitioner recovered the amount of money disbursed in excess of the amount received, together with interest in the amount of $16,305.71, which was paid to the petitioner in the year 1920.

If the Government had paid to the petitioner the amount of the judgment, $176,271.88, during the years in which the work was done, the petitioner's accounts for this dredging work would have exactly balanced as to receipts and disbursements, and it would have had no gain and no loss as the result of the enterprise. The amount of the judgment recovered in 1920, exclusive of the interest was, to use the language of the U. S. Supreme Court in U. S. v. Atlantic Dredging Co., 253 U. S. 12, "compensatory of the cost of the work of which the Government got the benefit."

The revenue act of 1918 levies income and profits taxes upon "gains or profits and income derived from any source whatever," and in Eisner v. Macomber, the Supreme Court defines income to be "the gain derived from capital, from labor, or from both combined." Gains, profits, and income are not produced by the judgment of a court but must be derived from the use of capital or labor, or both combined, in the circumstances and conditions which form the basis of the litigation resulting in the judgment. The facts in the instant case show conclusively that excluding the item of interest the use of the petitioner's capital and its employment of labor in the dredging enterprise produced no gains or profits.

While it is clearly established that during the years 1913 to 1916, inclusive, the petitioner sustained money losses in respect to this dredging enterprise aggregating $176,271.88, it may be true that in making the petitioner's income-tax returns for those years it recouped some small portion of such losses by reducing the amount of its income-tax liability for those years by using those losses as deductions. If such be the fact, and that can be clearly ascertained by an examination

of petitioner's income-tax returns for those years, the amounts by which petitioner's tax liability for those years was reduced can now be determined and such amounts may be properly found to fall within the definition of income in the year 1920, when it was finally
21 compensated for the losses sustained in the earlier years.

I am, therefore, of the opinion that in determining petitioner's gross income for the year 1920 there should be added to the amount originally reported the $16,305.71 of interest received in 1920, together with the amounts by which its income taxes for the years 1913 to 1916, inclusive, were reduced by the use of the dredging enterprise losses as deductions from gross income for those years.

SMITH concurs in the above dissent.

Dissenting opinion

PHILLIPS, dissenting: I concur in the opinion expressed in the first three paragraphs of the dissenting opinion propered by my associate but can go no further with him. It is my opinion that the judgment of the court in 1920 established that the expenditures made in prior years in excess of receipts were not in fact losses, but moneys expended for the benefit of the United States, the expenditure of which gave rise to an action to recover the amount. If this be so, there was no loss in the years 1913 to 1916 and no income in 1920 when the amounts due petitioner were recovered by it.

Now, December 19, 1928, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Order of redetermination

Pursuant to the board's findings of fact and opinion, promulgated April 9, 1928, it is
22 Ordered and decided: That, upon redetermination, there is deficiency for the years 1919 and 1920 in the respective amounts of $3,818.15 and $50,883.90.

(Signed) B. H. LITTLETON,
Member United States Board of Tax Appeals.

Dated Washington, D. C.
Enter:
Entered Apr. 10, 1928.

Now, December 19, 1928, the foregoing order of redetermination certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Petition for review by the United States Circuit Court of Appeals for the Fourth Circuit of the decision of the United States Board of Tax Appeals, promulgated April 9th, 1928

Filed Oct. 4, 1928

Sanford & Brooks Company, by Harry N. Baetjer, its attorney, respectfully petitions the Honorable the United States Board of Tax Appeals and the Honorable the United States Circuit Court of Appeals for the Fourth Circuit for a review of the decision promulgated April 9th, 1928, in the above entitled cause, ordering and deciding that there existed a deficiency in tax paid by Sanford & Brooks Company for the years 1919 and 1920, in the respective amounts of $3,818.15 and $50,883.90.

23 Sanford & Brooks Company, appellant, respectfully says:

FIRST

That in the years 1913, 1914, 1915 and 1916, Sanford & Brooks Company, as agent for the Atlantic Dredging Company, was engaged in making excavations in the Delaware River, under a contract with the United States. In those years it lost on that contract $176,271.88; the losses as made in the several years being as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89

In 1916 the taxpayer learned that certain representations made on behalf of the Federal Government, on the strength of which it entered into the contract, were false: It discontinued the work and sued the United States in the Court of Claims on account of the expenditures made and the loss sustained by it in the performance of the contract. The Court of Claims allowed the taxpayer an amount equal to the cost of doing the work under the contract in excess of the amount paid for the same by the Federal Government, with interest; on appeal the decision of the Court of Claims was affirmed by the Supreme Court of the United States.

In 1920 the Government paid the appellant the amount found to be due by it in accordance with the opinion of the Supreme Court, viz, $176,271.88, with interest thereon amounting to $16,305.71.

The taxpayer accounted for the interest in the above amount as income received in the year 1920, but did not account for the balance of the amount recovered as income, on the theory that it was a return to it of money which it had expended and was not income.

The Commissioner of Internal Revenue contended that the entire amount, principal and interest, so received by the taxpayer in 1920 was income to it for that year. In reply to the contention of the commissioner the taxpayer claimed that if the principal amount paid to it was income at all it was properly allocable to the
24 years 1913, 1914, 1915, and 1916 in the amounts as to each of said years equal to the losses sustained by it in those years, respectively, on the above-named contract, and, although insisting upon its position as taken that the principal recovered was not income at all, it filed amended tax returns allocating this principal amount so received to the years 1913, 1914, 1915, and 1916 in the above amounts, respectively.

The taxpayer further contended that if the principal sum so received by it was income it was properly allocable to the years 1913, 1914, 1915, and 1916 in the above amounts, respectively, and that inasmuch as it had continuously since 1913 owned amounts in excess of the amount recovered the amounts so allocated to said years constitute increases for those years, respectively, and for all subsequent years to and including 1919, in the amount of its invested capital, a percentage of which (8%) it was entitled to deduct in calculating the amount of its excess profits taxes. If the last contention were correct, taxpayer contends that not only would there not be any liability against it for additional taxes for 1919 and 1920, but that it would have overpaid its taxes and would be entitled to a refund; except for the contention that if the amount involved is income then its invested capital was properly increased for the year 1919, rendering no additional tax due by it, there is no dispute as to additional taxes claimed for that year.

The claim for additional taxes for the year 1920, however, and the finding by the United States Board of Tax Appeals that such additional taxes are due, rests upon the finding that the principal of the monies received from the Federal Government in 1920 is income to the taxpayer and is income for the year in which it is received, viz, 1920, and is not allocable to the years 1913, 1914, 1915 and 1916.

SECOND

This petition seeks the review by the United States Circuit Court of Appeals for the Fourth Circuit of the aforementioned order of April 9th, 1928, of the United States Board of Tax Appeals.

25 THIRD

The errors asserted and intended to be argued are the findings by the United States Board of Tax Appeals:

(1) That the principal of the monies paid to the taxpayer by the United States of America pursuant to the decision of the Court of Claims of the United States, affirmed by the Supreme Court of the United States and received by the taxpayer in the year 1920, was

income to the taxpayer subject to tax, the taxpayer asserting and intending to argue that said sum was not income to it;

(2) that the principal sum so paid to the taxpayer by the United States of America was income to the taxpayer for the year 1920, in which year the money was paid to it and that the same was accountable for taxation as income received in the year 1920, the taxpayer asserting and intending to argue that if said sum of money was income at all, which it denies, it was allocable to the four years hereinbefore mentioned in the following amounts, respectively, viz:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89

and as a corollary to (2) above:

(3) that the principal sum so paid by the United States of America is income but is not allocable to the years 1913, 1914, 1915, and 1916, and that no part thereof constitutes additions to the invested capital of the taxpayer for any of the years 1913 to 1919, both inclusive, and that taxpayer is not entitled to deduct any percentage of said additions in calculating the amount of its income subject to excess profits taxes for the year 1919.

Wherefore, Sanford & Brooks Company, taxpayer, respectfully prays that the decision of the United States Board of Tax
26 Appeals, promulgated April 9th, 1928, in the above captioned cause, be reviewed by the United States Circuit Court of Appeals for the Fourth Circuit.

Respectfully submitted.

SANFORD & BROOKS COMPANY,
By W. B. BROOKS, *President.*

Attest:
[SEAL.] A. L. HART, *Secretary.*

HARRY N. BAETJER,
Counsel for taxpayer.

Duly sworn to by Walter B. Brooks and A. L. Hart. Jurat omitted in printing.

27 Receipt of a copy of the within petition for review is hereby admitted this 4th day of Oct., 1928.

C. M. CHAREST, VII.

Now, December 19, 1928, the foregoing petition for review certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Amended praecipe for record

To the Honorable, the Clerk of the United States Board of Tax Appeals:

Please transmit to the United States Circuit Court of Appeals for the Fourth Circuit the following papers in the above captioned matter, to the end that the decision of the United States Board of Tax Appeals in said matter may be reviewed by said Court, viz:

1. The docket entries of the proceeding before the board.
2. Pleadings before the board.
28 3. Findings of fact, opinion and decision of the board.
4. Order of redetermination.
5. Petition for review.
6. Order of said board by a member thereof extending the time for the transmission to said United States Circuit Court of Appeals of the above papers, to the date fixed in said order.
7. This amended praecipe.

All of said papers to be duly certified as correct copies of the originals thereof.

HARRY N. BAETJER,
Solicitor for Petitioner.

Service acknowleged this 3rd day of December, 1928.

C. M. CHAREST,
General Counsel, Bureau of Int. Rev.,
Solicitor for Respondent.

Now, December 19, 1928, the foregoing amended praecipe certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

29 In United States Circuit Court of Appeals for the Fourth Circuit

No. 2827

SANFORD & BROOKS COMPANY, PETITIONER

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition to review the decision of the United States Board of Tax Appeals

Docket entries

December 31, 1928, the transcript of record is filed and the cause docketed.

Same day, the appearance of Harry N. Baetjer is entered for the petitioner.

Same day, certified copy of order enlarging the time for the filing of the record is filed.

January 5, 1929, the appearance of Mabel Walker Willebrandt, Assistant Attorney General; C. M. Charest, General Counsel, Bureau of Internal Revenue; and Clark T. Brown, Special Attorney, Bureau of Internal Revenue, is entered for the respondent.

January 15, 1929, twenty-five copies of the printed record are filed.

March 2, 1929, stipulation as to the time for the filing of respondent's brief is filed.

30 April 2, 1929, the appearance of Sewall Key, Special Assistant to the Attorney General; John Vaughan Groner, Special Assistant to the Attorney General; and Andrew D. Sharpe, Special Assistant to Attorney General, is entered for the respondent.

ARGUMENT OF CAUSE

April 22, 1929 (April term, 1929), cause came on to be heard before Waddill, Parker, and Northcott, circuit judges, and is argued by counsel and submitted.

31 In United States Circuit Court of Appeals

Fourth Circuit

No. 2827

SANFORD & BROOKS COMPANY, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition to review the decision of the United States Board of Tax Appeals

(Argued April 22, 1929. Decided October 15, 1929.)

Before WADDILL, PARKER, and NORTHCOTT, Circuit Judges.

Opinion

Filed October 15, 1929

32 PARKER, Circuit Judge: This is a petition by a taxpayer to review a decision of the Board of Tax Appeals. Petitioner, as agent for the Atlantic Dredging Company, was engaged during the years 1913, 1914, and 1915 in dredging a part of the Delaware River under a contract with the United States. It expended in the performance of the contract a total of $176,271.88 in excess of the amounts received thereunder. In December, 1915, it learned that certain vital representations, on the faith of which the contract had

been accepted, were untrue, whereupon, it stopped work and, in 1916, instituted suit against the United States in the Court of Claims for the losses under the contract and for the profits which would have been realized on the basis of a contract subsequently entered into. The Court of Claims gave judgment in favor of petitioner, but only for the actual loss which it had suffered; and this judgment was affirmed by the Supreme Court (U. S. v. Atlantic Dredging Co. 253 U. S. 1) on the ground that it was "simply compensatory of the cost of the work, of which the Government got the benefit."

Under this judgment there was paid to petitioner in the year 1920 the sum of $192,577.59, which amount represented the $176,271.88 loss with interest on same amounting to $16,305.71. The Commissioner of Revenue held that this entire amount was taxable as income for the year 1920; and the Board of Tax Appeals sustained this holding. Petitioner concedes that the $16,305.71 representing interest is thus taxable, but contends that the $176,271.88, being mere reimbursement of loss, is not. It appears that in its returns for the years 1913 to 1916 petitioner claimed as losses the excess of expenditures over receipts under the contract and that this served to decrease the income reported during these years. After the collection of the judgment, however, it filed, or proposed to file,
33 amended returns for the years in question, eliminating the losses claimed under the contract, which had been reimbursed under the recovery against the Government.

Two questions are presented by the petition: (1) whether the amount collected under the judgment in reimbursement of the losses sustained under the contract is taxable income within the meaning of the income tax law: and (2), if not, whether petitioner, by reporting the excess of expenditures over receipts under the contract as losses during the years when they occurred, must be held to have made a final election in the matter and to be now estopped thereby from claiming that the recovery should be treated as extinguishment of loss and not as income. We think that both of these questions must be answered in the negative.

On the first question, it should be observed that income, even gross income, within the meaning of the taxing acts, is not synonomous with receipts; for receipts may represent a mere reimbursement of capital expenditure, and certainly it was not the intent of Congress to tax this. See opinion of Commissioner Korner in the appeal of James P. McKenna 1 B. T. A. 326, 333. There has been much discussion as to what is meant by "income" as that word is used in the income tax laws; but it would seem that the Supreme Court has settled the matter. After full consideration, that court has declared that income within the meaning of these laws may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital assets. Eisner v. Macomber 252 U. S. 189, 207; Bowers v. Kerbaugh-Empire Co. 271 U. S. 170, 174.

Now the amount collected by the petitioner as reimbursement of loss is certainly not income within this definition. It is not gain derived from capital, from labor or from any other source. A case directly in point is that of Marshall v. Commissioner 10 B.
34 T. A. 1140, in which it was held that an amount received under the War Minerals Relief Act, as partial reimbursement for losses sustained, did not constitute income. In that case it appeared that the taxpayer in 1918 had erected a plant for carrying out a Government contract. With the signing of the armistice it found itself with a worthless plant on its hands, from which only a small amount was realized as salvage. In 1921 the Government reimbursed it for its capital outlay to the extent of $20,048.77. In holding that this was not taxable as income for the year 1921, the Board of Tax Appeals said: "We do not see how the partial reimbursement for losses sustained can be construed to be income", and quoted from Bowers v. Kerbaugh, supra: "The mere diminution of loss is not gain, profit, or income."

It is said however, that each year must be treated as a unit for income tax purposes, and that for this purpose we must view the expenditures and collections of each year entirely apart from those of other years. It is undoubtedly true that the year is the unit in income taxation and that income received or accrued within a given year must be reported as of that year: but it by no means follows that the events of other years may not be considered along with a particular item of alleged income in determining whether it constitutes taxable income or mere reimbursement of loss. As a matter of fact, the regulations of the Treasury Department in many instances expressly provide for reference to matters occurring in other years as a means of determining the income of a particular year. Thus under article 52 of Regulation 45, issued under the 1918 act, it is provided:

"In view of the unusual conditions prevailing at the close of the year 1918 it is recognized that many items of gross income, such as claims for compensation under cancelled contracts, together
35 with claims against contracting departments of the Government for amortization and other matters, while properly constituting gross income for the taxable year 1918 were undecided and not sufficiently definite in amount to be reported in the original return for that year. In every such case the taxpayer should attach to his return a full statement of such pending claims and other matters, and when the correct amount of such items is ascertained an amended return for the taxable year 1918 should be filed."

We are dealing here with a long-term contract, extending into a number of taxing periods; and from the beginning of the experience of the Federal Government with income taxation, it has been found necessary to provide either for the return of income after the completion of such a contract or for the amending of returns at that time upon the basis of facts then ascertained. See T. D. 2161; Regulation 33, Art. 121; Regulation 45, Art. 36; Regulation 69, Art. 36;

Regulation 74, Art. 334. Regulation 33, Art. 121, while directed to the application of the act of Sept. 8, 1916, was based upon Treasury Decision 2161, which was promulgated Feb. 19, 1915, in construing the act of 1913. That article provided:

"Art. 121. Contracting corporations.—Corporations engaged in contracting operations and which have numerous uncompleted contracts, which in some cases run for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work—that is, on jobs which have been finally completed—any and all moneys received in payment for completed jobs will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from gross income should be limited to the expenditures made on account of such completed contracts.

36 "Income on basis of estimates.—Or the percentage of profit from the contract may be estimated on the basis of percentage of completion and payments made thereon, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year; all under or over statements of income to be adjusted upon completion of the contract and return made accordingly. (T. D. 2161.)"

This article was brought forward in substantially the same form in the other regulations referred to above. The last clause of the article, however, was changed in subsequent regulations, evidently for the purpose of clarity, so as to provide:

"Upon the completion of a contract if it is found that as a result of such estimate or apportionment the income of any year or years has been overstated or understated, the taxpayer must file amended returns for such year or years."

The case of the petitioner here falls within the spirit if not within the letter of this regulation. Its contract with the Government was never completed in a technical sense; but upon the collection of the judgment there was a completion of what was necessary to be done to determine what was to be received for the work done under the contract. Petitioner then, under the regulation quoted, should have filed amended returns for the years for which it appeared that its income had been understated as a result of deducting supposed losses arising during the contract's performance; for the amount received from the Government was reimbursement of these losses, not gain or profit or other accretion of wealth.

37 The case of U. S. v. Anderson, 269 U. S. 422, is cited as sustaining the proposition that each twelve months' period must be treated as a unit for the determination of income for tax purposes, "each taxable period standing alone, with items of income

and deductions determined according to the events of that year." That case, however, does not support any such proposition. It holds that, where a corporation keeps its books and makes its returns upon the accrual basis, it is not permissible to defer to a subsequent year the deduction of a tax, imposed on business done during the year, merely because such tax is assessed and paid during the subsequent year; and the basis of the decision is that the taxpayer, having elected to keep its books and report its income upon the accrual basis, must deal with all matters where practicable, including taxes, upon the same basis. There is nothing in the decision which lends any support to the proposition that reimbursement of loss is to be treated as income because received in a year subsequent to that in which the loss occurred.

Nor do we think that the action of petitioner in claiming the losses under the contract as deductions from income for the years 1913 to 1916 estops it from denying that the recoupment of these losses is income. It is true, of course, that in ordinary cases where credit is taken for a loss, as by charging off a bad debt, its subsequent recoupment will be treated, not as reimbursement of loss, but as receipt of income. See Regulation 69, Art. 50. But this rule is based upon the fact that the taxpayer, with knowledge of his rights deliberately chooses to treat the loss as absolute and to make settlement of the taxes for the year upon that basis. Having done this, he will not be heard to say thereafter that he received value from what he deliberately elected to have the government treat as worthless. We do not think, however, that this rule has any
38 application in the case of a long term contract, as to which the regulations expressly provide for the filing of amended returns where, upon its completion, it is found that the income of any year or years has been overstated or understated. Petitioner's deduction of losses during the years when the contract was being performed is not analogous to the deduction of a loss resulting from the charging off of a bad debt. Here nothing was charged off. Losses were claimed as a result of expenditures made in the ordinary course of business; but petitioner had no claim under its contract for reimbursement of these expenditures, and no claim on account thereof was charged off or was even set up as an asset on its books, until after the collection of its judgment. Estoppels are not favored in the law; and, in the fact that the excess of expenditures over receipts was claimed as a loss, we see nothing which should be held to estop petitioner from treating reimbursement of this loss in accordance with its true character.

The case of Inland Products Co. v. Blair (C. C. A. 4th) 31 Fed. (2d) 867, is very much in point. In that case the government had erroneously collected a soft drink tax upon sales of sweet cider, and the amount so collected had subsequently been refunded. The tax-

payer had claimed as deductions from his taxable income the amounts paid as tax. This Court held that, upon refunding the moneys erroneously collected, the government could reform the tax returns for the years when the taxes were paid and eliminate the deductions claimed on account thereof. The taxpayer strenuously contended that the refund should be treated as income in the year when receiver, and that we had no right to consider subsequent occurrences as bearing upon matters covered by the returns. We thought, however, that we should regard substance and not form and should treat the refund of the taxes not as the receipt of
39 income but as the correction of a mistake. The same principle is applicable here. The recovery of the $176,271.88 was not, it is true, the correction of a mistake; but it was a payment in reimbursement of a loss for which a deduction had been claimed, just as it had been claimed in the case of the taxes erroneously paid.

After all has been said that can be said with regard to the various technical aspects of the case at bar, the fact remains that to sustain the tax on the $176,271.88 recovered as reimbursement for loss is to sustain a tax on income where no income has been in fact received. We do not see how this could be justified either under the income tax law itself or under any legal principle which could be invoked in its interpretation. There can be no doubt that the right and justice of the case require that the $176,271.88 be treated not as income but as reimbursement of loss; and we know of no legal principle under which what is so manifestly just and right may be defeated and the Government placed in the unseemly position of reimbursing a loss with one hand and, under the guise of taxation, taking away a part of the reimbursement with the other.

The decision of the Board of Tax Appeals will be reversed, and the case will be remanded with directions that upon petitioner filing amended returns for the years 1913 to 1916, eliminating the deductions claimed on account of the loss which has been reimbursed, the amount received in reimbursement be eliminated from the computation of taxable income for the year 1920. Of course, the item of $16,305.71, received as interest, should be included in the computation of income for that year.

Reversed and remanded.

Dissenting opinion

NORTHCOTT, Circuit Judge, dissenting: The petitioner, as agent for the Atlantic Dredging Company, was engaged in dredging a
40 part of the Delaware River during the years 1913, 1914, 1915, and 1916, under a contract with the United States. It expended, in those years, in doing the work, a total of $176,271.88 in excess of the payments received for the same, the amount of said excess, allocated to those years (1913 to 1916) on the basis of excess

of expenditures made over payments received in each year, being as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89
Total	176,271.88

In the year 1916 petitioner learned that certain representations which had been made on behalf of the United States, and on the strength of which the contract was accepted, had been misleading, and it discontinued the work and instituted suit in the Court of Claims against the United States to recover the amount of loss sustained by it, in the performance of the contract as well as damages.

The Court of Claims found that the expenditures made by petitioner in the performance of the contract had amounted to $211,050.00 more than it had received in payment for the work, which amount the court allowed to the claimants. On appeal to the Supreme Court of the United States, the judgment of the Court of Claims was affirmed and there was accordingly paid to the taxpayer in 1920 the amount of the judgment rendered in its favor, with interest thereon amounting to $16,305.71, a total recovery of $227,355.80. The Atlantic Dredging Company was entitled to and there was paid to it $34,778.21, making the net amount received by the petitioner $192,577.59.

41 This appeal is taken from the final order of the United States Board of Tax Appeals, holding that the amount received by the petitioner in the year 1920 was properly included in the petitioner's gross income for that year for the purpose of taxation.

The statute involved is revenue act of 1918, c. 18, 40 Stat. 1057, 1058, 1070.

The petitioner contends that instead of being taxed on the amount in controversy in 1920 as a part of its gross income that its returns for the years 1913, 1914, 1915, and 1916 should be reformed in accordance with the recovery had for the losses during those years in the contract in question. Petitioner further contends, in view of the fact that there was no profit recovered by it on the contract, the amount recovered in the year 1920, besides from the interest, was not gross income for the purpose of taxation, and petitioner further contends that, as it was finally settled in the litigation that the United States was at fault with regard to the contract, it would be an injustice to permit the Government to recover taxes on the amount paid by it, when no profit was earned in the transaction.

It must be borne in mind that the Government in procuring the dredging in the Delaware River acted in a different capacity from that in which it acted as tax gatherer in the year 1920, and this case must necessarily be considered just as though the dredging contract had been made by the petitioner with a private corporation or an individual.

The sum received in 1920, in satisfaction of a judgment on account of work previously done, although no profit is included, undoubtedly constitutes gross income for the year 1920. The business was carried on in effort to make a profit, and the fact that no profit resulted does not change the character of the money received.

The year is necessarily the unit for the determination of
42 income for tax purposes, each taxable period standing alone; the result determined according to the events of that year.

United States v. Anderson, 269 U. S. 422.

This must of necessity be the case. Let it be supposed that the petitioner instead of losing during the four years involved, and recovering in the one year, had lost in one year, and had recovered on doubtful claims in four different years subsequently, certainly upon recovery in each of the four years the Government could not be required to go back and reform the tax assessment for the one year in which the loss was incurred, or four different times. To hold this would be to hold that the assessment of taxes by the Government would never be completed for any given year, and would bring about a situation that would be chaotic.

" * * * In interpreting the law we are not to assume that a system based upon yearly gains and losses was so contrived as to admit deviations in principle which must always operate to the taxpayer's advantage."

DeLoss v. Commissioner, 28 Fed. (2) 803.

Under the revenue act of 1913, under which the original returns by petitioner for years 1913, 1914, 1915, and 1916 were made, the income to be reported was that " received " during the year for which the return was made.

Maryland Casualty Company v. United States, 251 U. S. 342.

Compensation for services rendered or work done must be reported as gross income for the year when received, regardless of the year in which the work was performed.

Jackson v. Smietanka, 267 Fed. 932.

Edwards v. Keith, 231 Fed. 110.

Woods v. Lewellyn, 252 Fed. 106.

43 The fact, that the losses were made and reported over a period of four years and the recovery had in one year worked to the financial disadvantage of the petitioner, is merely an incident. It might have worked to his advantage. In any event, the whole tax collection system of the Government can not be upset or changed to meet the exigencies of a particular case. One rule must be laid down for all, and Congress has seen fit to lay down the rule that the year is the unit, and we can see no reason for disregarding the rule.

It is contended on behalf of the petitioner that the cases of Eisner *v.* Macomber, 252 U. S. 189, and Bowers, collector *v.* Kerbaugh-Empire Company, 271 U. S. 170, support their contention. I do not think so. These decisions are not properly applicable to the facts in this case.

44 In United States Circuit Court of Appeals

Fourth Circuit

No. 2827

SANFORD & BROOKS COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Judgment

Filed and Entered October 18, 1929

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the decision of the said Board of Tax Appeals, in this cause, be, and the same is hereby, reversed, and that this cause be, and the same is hereby, remanded to the said United States Board of Tax Appeals for further proceedings in accordance with the opinion of the court filed herein.

JOHN J. PARKER,
U. S. Circuit Judge.

October 18, 1929.

45 November 12, 1929, petition of respondent for stay of the mandate is filed.

In United States Circuit Court of Appeals

Order staying mandate

Filed November 12, 1929

Upon the application of the respondent, by C. M. Charest, Esq., his counsel, and for good cause shown,

It is ordered, That the mandate of this court in the above case be, and the same is hereby, stayed pending the application of the respondent in the Supreme Court of the United States for a writ of certiorari to this court, unless otherwise ordered by this or the said Supreme Court, and provided said application is filed in the said Supreme Court within 30 days from this date.

JOHN J. PARKER,
U. S. Circuit Judge.

November 12, 1929.

November 20, 1929, petition of petitioner and stipulation that Robert H. Lucas, Commissioner of Internal Revenue, be substituted as party respondent, is filed.

In United States Circuit Court of Appeals

Order substituting Robert H. Lucas for David H. Blair

Filed and entered November 20, 1929

Upon the above motion and stipulation, it is this 20" day of November, 1929, by the United States Circuit Court of Appeals, Ordered, That the motion be granted and that the above-entitled cause be revived so that the same will be pending as against Robert H. Lucas, as Commissioner of Internal Revenue of the United States.

And it is further ordered, That said Robert H. Lucas, as such Commissioner of Internal Revenue, be substituted in the above-
46 entitled cause for David H. Blair, formerly Commissioner of Internal Revenue of the United States.

EDMUND WADDILL, JR.,
U. S. Circuit Judge.

December 11, 1929, motion of respondent for a further stay of the mandate is filed.

In United States Circuit Court of Appeals

Order further staying mandate

Filed December 11, 1929

Upon the application of the respondent, by C. M. Charest, Esq., general counsel, Bureau of Internal Revenue, and for good cause shown,

It is ordered, That the mandate of this court in the above case be, and the same is hereby, further stayed pending the application of the respondent in the Supreme Court of the United States for a writ of certiorari to this court, unless otherwise ordered by this or the said Supreme Court, and provided said application is filed in the said Supreme Court within 30 days from this date.

EDMUND WADDILL, JR.,
United States Circuit Judge.

December 11, 1929.

47 [Clerk's certificate to foregoing transcript omitted in printing.]

48 Supreme Court of the United States

Order allowing ceritorari. Filed March 3, 1930

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And

it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] File No. 34710. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 579. Robert H. Lucas, Commissioner of Internal Revenue, Petitioner, vs. Sanford & Brooks Company. Petition for writ of certiorari and exhibit thereto. Filed January 16, 1930. File No. 34710

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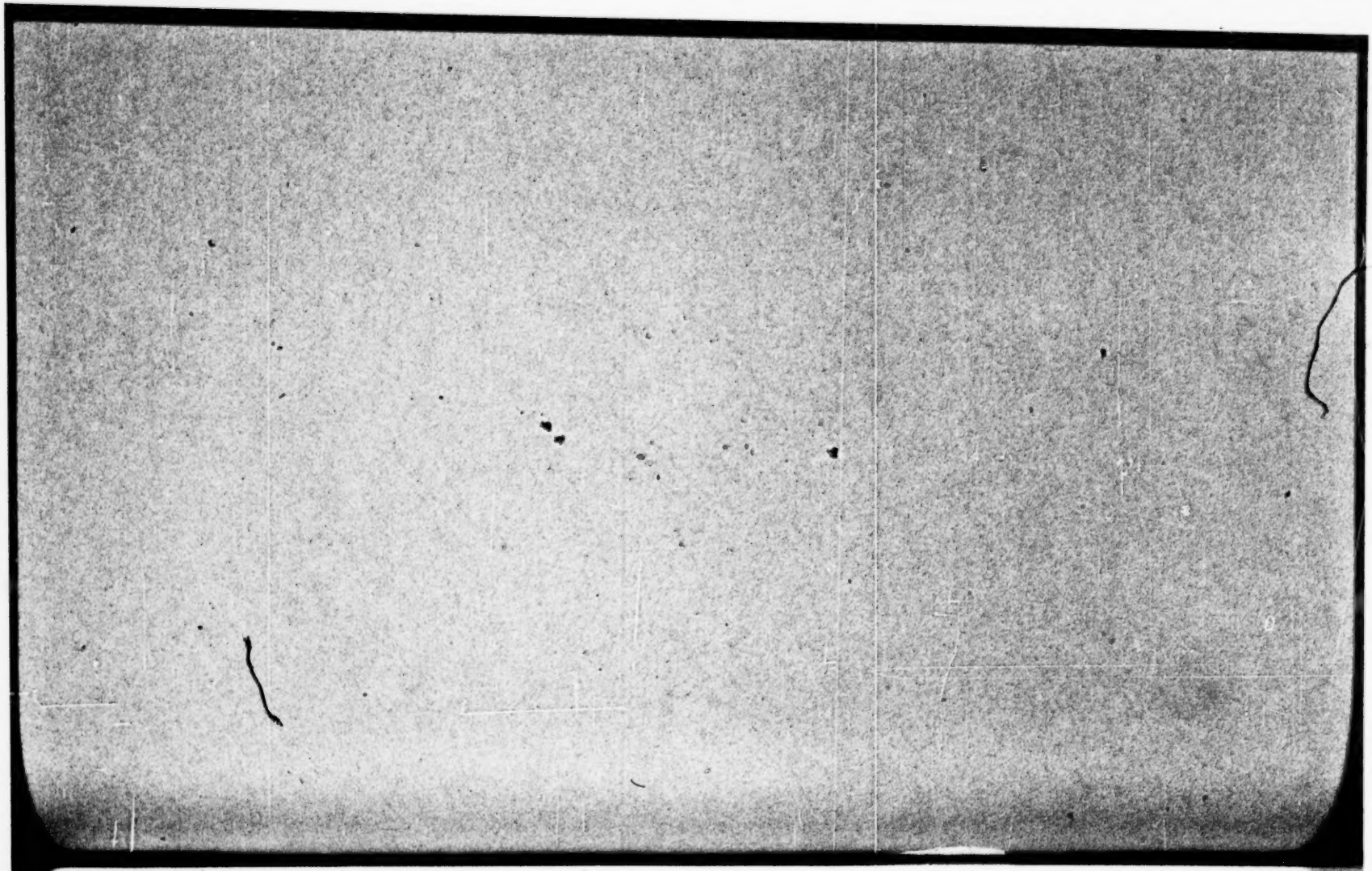

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No. 31

In the Supreme Court of the United States

OCTOBER TERM, 1929

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SANFORD & BROOKS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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In the Supreme Court of the United States

OCTOBER TERM, 1929

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SANFORD & BROOKS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, entered in the above case on October 18, 1929, reversing a decision of the United States Board of Tax Appeals. (R. 37.)

STATEMENT

In 1912 the Atlantic Dredging Company entered into a contract with the United States Government to dredge a part of the Delaware River, and the respondent, as agent for the Atlantic Dredging Com-

pany, was engaged in carrying on the work under said contract during the years 1913, 1914, and 1915. Having operated at a loss under the contract, the respondent, in December, 1915, refused to proceed with the work. In 1916 it brought suit in the Court of Claims against the United States to recover the sum of $545,121.72 on the ground that the United States has failed to make a proper disclosure in its specification of the character of the material to be dredged. The suit was brought in the name of "Atlantic Dredging Company, W. E. Brooks, Agent." (R. 12.)

On June 3, 1918, the Court of Claims decided that the Atlantic Dredging Company was entitled to recover the sum of $211,050.09, and entered a judgment in that amount. *Atlantic Dredging Co.* v. *United States*, 53 C. Cls. 490. (See also R. 13.)

This Court affirmed the judgment on April 26, 1920. *United States* v. *Atlantic Dredging Co.*, 253 U. S. 1. (See also R. 13.)

The amount of the judgment, $211,050.09, together with interest in the sum of $16,305.71, or a total of $227,355.80, was paid in 1920. (R. 13.)

Of the amount recovered, the Atlantic Dredging Company received $34,778.21 and the respondent $192,577.59. This latter sum included interest in the amount of $16,305.71, leaving a balance of $176,271.88, which respondent received for the work which it had performed. (R. 13.)

The actual expenditures of respondent in carrying out the contract amounted to $354,009.19. The

amount paid respondent by the Government, under the contract and the supplemental contract subsequently entered into, was $142,959.10. The difference, $211,050.09, was recovered under the judgment. (R. 13.)

The principal sum received by respondent under the judgment, $176,271.88, represents the difference between the amounts received by respondent under the contract, during each of the years 1913, 1914, 1915, and 1916, and the amounts expended by respondent in performing the work during each of those years. (R. 13.) These expenditures were reported in the respondent's returns for the years in question. The returns showed losses for 1913, 1915, and 1916 and net income for 1914. (R. 14.)

Prior to 1920 the United States denied all liability to respondent for any sum in addition to that due under the contract and paid. Furthermore, respondent did not carry on its books, as an asset, any sum relating to its claim against the Government until payment of the judgment was had, in 1920. (R. 13.)

Respondent did not include in its return for 1920 the amount of the judgment recovered against the United States. (R. 14.)

The Commissioner of Internal Revenue, in reviewing the respondent's return, determined that the entire amount paid pursuant to the judgment was income for 1920 and as a result asserted a deficiency in tax of $50,883.90. (R. 12.) The respondent took an appeal to the Board of Tax

Appeals, which rendered its decision April 10, 1928, upholding the determination of the Commissioner. (R. 21–22.) From this decision of the Board of Tax Appeals, the respondent, on October 4, 1928, appealed to the Circuit Court of Appeals for the Fourth Circuit (R. 22), which, on October 18, 1929, reversed the decision of the Board of Tax Appeals, holding that the amount collected under the judgment in question constituted reimbursement of losses sustained under the contract, and as such was not taxable income. It remanded the case with directions that upon the filing of amended returns for 1913 to 1916, eliminating the deductions claimed on account of the loss which had been reimbursed, the amount received in reimbursement should be eliminated from the computation of taxable income for the year 1920. One judge dissented. (R. 30–36).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred—

I. In holding that the amount collected in 1920 under the judgment against the United States should be excluded from the taxpayer's gross income for that year.

II. In considering and deciding questions directly affecting tax liability for the taxable years 1913 to 1916, when such taxable years were not involved in the taxpayer's petition to the Board of Tax Appeals.

III. In holding that by virtue of the collection of a judgment against the United States in 1920 the

taxpayer's returns for 1913 to 1916, inclusive, may properly be amended by eliminating therefrom the deductions claimed for expenditures under its contract with the Government to the extent that such deductions exceed the amounts received under the contract.

REASONS FOR GRANTING THE WRIT

The Circuit Court of Appeals in deciding the instant case has apparently laid down the principle that the term "gross income" as used in the revenue laws relates only to profits and that where a transaction does not result in a profit any amount received at the termination of the transaction represents a recoupment of the expenses incurred and does not represent gross income. This principle finds no support in the statute.

The Circuit Court of Appeals has further held in effect that where expenditures were incurred on a contract during the years 1913 to 1916, and compensation for work performed (in addition to that paid under the contract), or damages compensatory of the additional cost of the work, were recovered in 1920 by means of a judgment, the latter sum did not constitute gross income for the year in which the judgment was rendered and collected.

It does not appear from the record whether the taxpayer's income for 1920 was reported on the cash basis or on the accrual basis. Accordingly, if the Commissioner's action in determining that the amount of the judgment constituted taxable income

for the year 1920 could have been sustained under either assumption, his determination of the deficiency, which determination was *prima facie* correct, should have been approved. *Wickwire* v. *Reinecke,* 275 U. S. 101; *United States* v. *Rindskopf,* 105 U. S. 418.

The Commissioner's action in treating the amount of the judgment as taxable income for the year 1920 is fully justified, if the taxpayer was on a cash receipts and disbursements basis, and the record does not establish that it was not. It is well settled that compensation for services rendered or work done must be reported as gross income for the year in which received regardless of the year or years in which it was performed. *Edwards* v. *Keith* (C. C. A. 2d), 231 Fed. 110; *Woods* v. *Lewellyn* (C. C. A. 3d), 252 Fed. 106; *Jackson* v. *Smietanka* (C. C. A. 7th), 272 Fed. 970. If, therefore, the amount of the judgment be regarded as additional compensation for the work performed, as it was by the Board, the same rule should apply here. Nor is the rule different if the judgment in fact represented damages measured by the additional cost of performing the work due to the misrepresentation of the Government.

The Circuit Court of Appeals, however, directed that the case be remanded with instructions that the amount of the judgment be eliminated from taxable income for the year 1920 upon the filing of amended returns for the years 1913 to 1916, "eliminating the deductions claimed on account of the loss which has

been reimbursed," that is, eliminating deductions for expenditures on the contract to the extent that they exceeded the compensation reported under it. None of the years in question were involved in the taxpayer's appeal to the United States Board of Tax Appeals from the Commissioner's determination or in the Board's order of redetermination. The case, therefore, raises an important question as to the extent to which the Circuit Court of Appeals, in reviewing a decision of the Board involving one year, may consider and decide questions affecting other years.

Moreover, this decision of the Circuit Court of Appeals as to 1913, 1914, 1915, and 1916 can only be justified on the theory that the amount of the judgment constituted income accrued during those years. But there was no statutory provision for returns on the accrual basis prior to 1916 and there is no finding that this taxpayer was on the accrual basis in any of those years. The decision is thus in conflict with *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, where it was held that under the Revenue Act of 1913 gross income should be reported for the year in which received.

The decision of the Circuit Court of Appeals has thus raised a doubt with respect to important questions of Federal tax law which it was thought had previously been settled otherwise and as to others which have not been, but should be, authoritatively decided by this Court.

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Wherefore, it is respectfully submitted that the petition should be granted.

CHARLES E. HUGHES, Jr.,
Solicitor General.

JANUARY, 1930.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals (R. 30–36) is reported in 35 F. (2d) 312. The opinion of the United States Board of Tax Appeals (R. 11–21) is reported in 11 B. T. A. 452.

JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered October 18, 1929. (R. 37.) The jurisdiction of this Court rests on the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

In 1920 the taxpayer recovered and collected a judgment against the United States for a sum equal to the amount by which expenditures made during the years 1913 to 1916 in performance of a contract exceeded the compensation received under it in those years. The questions are:

1. Should the amount of the judgment be included in the taxpayer's gross income for the purpose of determining its income-tax liability for the year 1920?

2. Did the Circuit Court of Appeals have authority to consider and decide questions directly affect-

ing tax liability for the years 1913 to 1916, inclusive, when such taxable years were not involved in the taxpayer's petition to the Board of Tax Appeals?

3. Should the income-tax liability of the taxpayer for the years 1913 to 1916, inclusive, be redetermined by eliminating the deductions for expenditures made under the contract to the extent that they exceeded compensation received under the contract during those years?

STATUTES INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064–1065, 1077:

> SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *
>
> * * * * * *
>
> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or

from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period * * *.

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213 * * *.

Revenue Act of 1926, c. 27, 44 Stat. 9, 55, 63, 110:

SEC. 274. (a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in section 279,

282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. * * *

(b) If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * *

(g) The Board in redeterminating a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

SEC. 283. (a) If after the enactment of this Act the Commissioner determines that any assessment should be made in respect of any income, war-profits, or excess-profits tax imposed by * * * the Revenue

Act of 1918, * * * or by any such Act as amended, the Commissioner is authorized to send by registered mail to the person liable for such tax notice of the amount proposed to be assessed, which notice shall, for the purposes of this Act, be considered a notice under subdivision (a) of section 274 of this Act. In the case of any such determination the amount which should be assessed (whether as deficiency or as interest, penalty, or other addition to the tax) shall, except as provided in subdivision (d) of this section, be computed as if this Act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations * * * as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in section 277 of this Act.

(b) If before the enactment of this Act any person has appealed to the Board of Tax Appeals under subdivision (a) of section 274 of the Revenue Act of 1924 (if such appeal relates to a tax imposed by Title II of such Act or to so much of an income, war-profits, or excess-profits tax imposed by any of the prior Acts enumerated in subdivision (a) of this section as was not assessed before June 3, 1924), and the appeal is pending before the Board at the time of the enactment of this Act, the Board shall have jurisdiction of the appeal. In all such cases the powers, duties, rights, and privileges of the Commissioner and of the person who has brought the

appeal, and the jurisdiction of the Board and of the courts, shall be determined, and the computation of the tax shall be made, in the same manner as provided in subdivision (a) of this section, except as provided in subdivision (j) of this section and except that the person liable for the tax shall not be subject to the provisions of subdivision (d) of section 284.

SEC. 1003. (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in section 239 of the Judicial Code, as amended); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

STATEMENT

A statement of the facts and of the errors relied on will be found in the petition.

ARGUMENT

The Circuit Court of Appeals in deciding the instant case has apparently laid down the principle that the term "gross income" as used in the revenue

laws relates only to profits and that where a transaction does not result in a profit any amount received at the termination of the transaction represents a recoupment of the expenses incurred and does not represent gross income.

The principle finds no support in the statute. Under the definition of gross income in Section 213 (a) of the Revenue Act of 1918, *supra*, a profit *may* constitute gross income, as for example where there are no expenditures in connection with the transaction, and the entire amount received constitutes a profit. The definition of gross income in that section, however, includes "gains or profits and *income* derived from any source whatever." If by the profit on a transaction is meant the excess of payments received over expenditures made, then to consider the term "gross income" as synonymous with "profits" as applied to corporate taxpayers would be to destroy the effect of other provisions of the statute which require such taxpayers to report in their return the allowable deductions from and credits against gross income, the tax being computed on the net amount remaining.

It follows that the question as to whether the sum of $176,271.88 received by this taxpayer pursuant to the judgment of the Court of Claims as affirmed by this Court constitutes gross income can not be decided by determining whether not any, or all, or only a part, of the judgment in question represented a profit. On the contrary, the decision is

necessarily controlled by the nature and purpose of the payment.

The record discloses that the taxpayer decided not to proceed under its contract with the Government for dredging the Delaware River and brought suit against the Government because of conditions which proved to be contrary to representations, and that prior to the abandonment of the work it had during 1913 to 1916 received from the Government on the basis of the unit prices set out in the original contract and a supplemental contract the sum of $142,959.10. (R. 12, 13.) In its finding of facts the Board of Tax Appeals stated that the amount of the judgment was paid to the taxpayer for work performed. (R. 13.) See also *Atlantic Dredging Co* v. *United States*, 53 C. Cls. 490, 253 U. S. 1. While, in view of the nature of the action which was brought and in view of the language of this Court's decision, it is probably more accurate to designate the amount of the judgment as damages compensatory of the added cost of the work performed, the same principles would apply in either case. Accordingly, for the purpose of this petition, the judgment will be referred to as compensation for work performed in accordance with the Board's findings of fact.

It is not readily perceived why the amount paid under the judgment as the result of this Court's decision is of a different character from the amounts received on the unit basis under the express con-

tract. Both were in the nature of compensation for work performed. The fact that the amount of the judgment did not show a profit to the respondent over the cost of doing the work does not change its character as gross income. In the case of any contract the expenditures may exactly equal the compensation received under such contract but the taxpayer in such case is not allowed to exclude the compensation from gross income. As stated by Circuit Judge Northcott in his dissenting opinion, the respondent's business was carried on in an effort to make a profit, and the fact that no profit resulted does not change the character of the money received. (R. 36.)

The case of *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, relied upon by the Circuit Court of Appeals, is distinguishable on the facts. In the instant case there was a transaction arising out of the operation of a business where compensation was collected for work performed in earlier years, the expenditures made in performing the work having been properly deducted in those years. In the *Kerbaugh-Empire Co. case* the whole transaction was a capital transaction. There the taxpayer borrowed money, giving a note payable in German marks, and there was a loss of the money borrowed; later the taxpayer settled the debt for a smaller amount in American currency, due to the decline in the rate of exchange.

The Circuit Court of Appeals' decision, moreover, in effect treated the amount of the judgment as income (though not for 1920), for it directed that when the taxpayer should file amended returns for the years 1913 to 1916, inclusive, eliminating the deductions for expenditures made in performing the contract to the extent that they exceeded the amounts received under it, the amount of the judgment should be eliminated from taxable income for the year 1920.

The record in this case does not show whether the taxpayer filed its return for 1920 on a cash receipts and disbursements basis or on an accrual basis. In a suit to recover a tax the determination of the Commissioner is prima *facie correct*, *Wickwire* v. *Reinecke*, 275 U. S. 101; *United States* v. *Rindskopf*, 105 U. S. 418, and the burden is on the taxpayer to establish the incorrectness of the Commissioner's determination. *Botany Mills* v. *United States*, 278 U. S. 282. The rule is the same in an appeal to the Board. *Avery* v. *Commissioner of Internal Revenue* (C. C. A. 5th), 22 F. (2d) 6. In view of this rule and the state of the record the Commissioner's determination was properly approved by the Board, if the Commissioner's action was justified either on the assumption that the taxpayer was on a cash basis or on the assumption that it was on the accrual basis. Since either assumption would justify the tax, the Circuit Court of Appeals erred in reversing the decision of the Board.

In the case of a taxpayer on the cash receipts and disbursements basis, Section 213 (a) of the Revenue Act of 1918, *supra*, requires that the items of gross income shall be reported for the year in which received. Moreover, it is well settled that compensation for services rendered or work done must be reported as gross income for the year in which received, regardless of the year in which the work was performed. *Edwards* v. *Keith* (C. C. A. 2d), 231 Fed. 110; *Woods* v. *Lewellyn* (C. C. A. 3d), 252 Fed. 106; *Jackson* v. *Smietanka* (C. C. A. 7th), 272 Fed. 970.

In the instant case the work was done in the years 1913 to 1916, but no portion of the compensation paid under the judgment was received until 1920. Obviously, it constituted gross income for 1920, if the taxpayer was on a cash basis. The regulations relating to long-term contracts which are quoted in the opinion of the Circuit Court of Appeals might have given this taxpayer the option of reporting all of the income received from the transaction on a different basis if it had availed itself of the privilege, but it did not elect to report it on that basis.

The Circuit Court of Appeals, however, directed that the case be remanded with instructions that the amount of the judgment be eliminated from taxable income for the year 1920 upon the filing of amended returns for the years 1913 to 1916, "eliminating the deductions claimed on account of the

loss which has been reimbursed"; that is, eliminating deductions for expenditures on the contract to the extent that they exceeded the compensation reported under it.

It is our position that the Circuit Court of Appeals had no authority to consider and determine any question directly affecting tax liability for the years 1913 to 1916. Upon an appeal from the Board of Tax Appeals, the jurisdiction of the Circuit Court of Appeals is limited to a review of the decision of the Board on errors of law.

In the instant case the Board entered no order of redetermination as to the years 1913 to 1916, and it had no power to do so, for no deficiencies had been determined for those years and the taxpayer's petition involved only the year 1920. While under Section 274 (g) of the Revenue Act of 1926, *supra*, the Board had authority to determine such facts for other years as were required for a correct determination of the taxpayer's liability for 1920, it was prohibited under that section from finding an overpayment or underpayment for those other years. *Wolf Mfg. Co.* v. *Commissioner of Internal Revenue,* 10 B. T. A. 1161; *D. L. Blackstone, Administrator* v. *Commissioner of Internal Revenue,* 12 B. T. A. 456.

If, however, we are in error as to the question of the jurisdiction of the Circuit Court of Appeals over the years 1913 to 1916, it is our position that that court's adjustment for those years could only

be justified on the theory that the amount of the judgment was then accrued. The loss on the contract which the returns for those years disclosed arose by virtue of the fact that the expenses incurred in connection with it exceeded the income. If, therefore, these so-called losses, which are in reality only an excess of expenditures over income, are to be eliminated, it can only be on the theory that there is additional income to apply against them. The amount of the judgment was obviously not income actually received until 1920. It follows, therefore, that if it is to be applied against the expenditures incurred during 1913 to 1916, as it has been under the Circuit Court of Appeals' decision, it must be treated as accrued income for those years. But the Revenue Acts contained no provision for returns on the accrual basis prior to 1916 and there is nothing in the record to show that this taxpayer was on that basis in any of the years in question.

If this be the correct view of the situation, and we believe that it is, the decision is contrary in principle to that of *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, where it was recognized that under the Revenue Act of 1913 gross income is to be reported when received. That decision necessarily controls the years 1913, 1914, and 1915.

CONCLUSION

We submit that the decision of the Circuit Court of Appeals was erroneous, and, in view of the general importance of the questions decided in the

administration of the tax laws, that the petition for certiorari should be granted.

CHARLES E. HUGHES, JR.,
Solicitor General.

G. A. YOUNGQUIST,
Assistant Attorney General.

J. LOUIS MONARCH,

HELEN R. CARLOSS,
Special Assistants to the Attorney General.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

PREW SAVOY,
Special Attorney,
Bureau of Internal Revenue.

JANUARY, 1930.

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No. 31

In the Supreme Court of the United States

OCTOBER TERM, 1930

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SANFORD & BROOKS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1930

No. 31

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SANFORD & BROOKS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 20–25) is reported in 35 F. (2d) 312. The opinion of the Board of Tax Appeals (R. 8–14) is reported in 11 B. T. A. 452.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 28) was entered October 18, 1929. The petition for a writ of certiorari was filed January 16, 1930, and was granted March 3, 1930 (R. 29–30), 281 U. S. 707. The jurisdiction of this Court rests

on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the amount of a judgment against the United States recovered and collected by the taxpayer in 1920, in a sum equal to the amount by which expenditures made during the years 1913 to 1916, in the performance of a contract, exceeded the compensation received under the contract in those years, should be included in a taxpayer's gross income for the year 1920.

STATUTES INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra* pp. 27–33.

STATEMENT

The record does not include the evidence. The essential facts were found by the Board of Tax Appeals. (R. 8–9.) The following is a verbatim copy with a few unimportant omissions. In the matter quoted, "petitioner" refers to the corporation which is the respondent in this Court. (R. 2.)

> In 1912 the Atlantic Dredging Company entered into a contract with the United States Government to dredge a part of the Delaware River. During the years 1913, 1914, and 1915, the petitioner, as agent for the Atlantic Dredging Company, was engaged in carrying on the work under the contract. In December, 1915, after having

operated at a loss under the contract to this time, the petitioner refused to proceed with the contract and subsequently, in 1916, brought suit in the Court of Claims against the United States to recover an amount of $545,121.72 in addition to the amount which had been paid it on the basis of the unit prices set out in the original contract and a supplemental contract later entered into. This suit was brought in the name of "Atlantic Dredging Company, W. E. Brooks, Agent." The basis on which recovery was sought was the failure on the part of the United States to make a proper disclosure in its specification of the character of the material to be dredged.

June 3, 1918, the Court of Claims decided that the Atlantic Dredging Company was entitled to recover the sum of $211,050.09 and entered judgment for that amount. *Atlantic Dredging Company* v. *United States,* 53 Ct. Cls. 490.

Upon appeal to the Supreme Court of the United States, this judgment was affirmed in a decision rendered April 26, 1920. *United States* v. *Atlantic Dredging Company, W. B. Brooks, Agent,* 253 U. S. 1.

The amount of the judgment, $211,050.09, together with interest of $16,305.71, or a total of $227,355.80, was paid in 1920. Of this amount the Atlantic Dredging Company received $34,778.21 and the petitioner $192,577.59. The latter amount included interest in the amount of $16,305.71, and left a balance of $176,271.88, which the peti-

tioner received under the judgment on account of work which it had performed.

The petitioner actually expended in the prosecution of the work the sum of $354,009.19. Prior to the recovery under the judgment of the Court petitioner had received from the Government on account of the work in question the sum of $142,959.10, making a difference between the amount expended and the amount received of $211,050.09, the amount recovered in the judgment. The part of this excess of expenditures over payments received, $176,271.88, which was applicable to the petitioner, related to the years 1913 to 1916 on the basis of the excess of expenditures over receipts in these years as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89
Total	176,271.88

The United States did not at any time prior to 1920 admit or recognize any liability to petitioner in addition to the amount set forth in the contract, nor did petitioner have the claim which formed the basis of the judgment on its books as an asset on account of a debt due from the United States until payment was received in 1920.

The excess of expenditures made over payments received from the contract in question served to decrease the income reported for the years 1913 to 1916. These returns showed losses for 1913, 1915, and 1916, and net income for 1914.

> The Commissioner held that the entire amount of the judgment was income in 1920, whereas the petitioner did not report any of it as income in 1920, but filed amended returns asking that it be treated as income in the years 1913 to 1916, inclusive.

The taxpayer appealed from the determination of the Commissioner to the Board of Tax Appeals. The Board rendered its decision on April 10, 1928, upholding the determination of the Commissioner, with three members dissenting. (R. 15.) From this decision the taxpayer appealed to the Circuit Court of Appeals for the Fourth Circuit. (R. 16.) That court, with one judge dissenting, reversed the decision of the Board of Tax Appeals, holding that the amount collected under the judgment in question constituted reimbursement of losses sustained under the contract and was not taxable income. It remanded the case with directions that, upon the filing of amended returns for 1913 to 1916, eliminating the deductions claimed on account of the loss, which has been reimbursed, the amount received in reimbursement should be excluded in the computation of taxable income for the year 1920. (R. 20–28.)

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred—

1. In holding that the amount collected in 1920 under the judgment against the United States should be excluded from the taxpayer's gross income for that year.

2. In considering and deciding questions directly affecting tax liability for the years 1913 to 1916, when such taxable years were not involved in taxpayer's petition to the Board of Tax Appeals.

3. In holding that by virtue of a judgment against the United States in 1920 the taxpayer's returns for 1913 to 1916, inclusive, may now be amended by eliminating therefrom the deductions claimed for expenditures under its contract with the Government to the extent that such deductions exceed the amount received under the contract.

SUMMARY OF ARGUMENT

I

The sum received in satisfaction of the judgment against the United States was properly a part of the taxpayer's gross income. The term "gross income," as defined in Section 213 (a) of the Revenue Act of 1918, includes "gains, profits and income derived from * * * trades, businesses * * * or the transaction of any business carried on for gain or profit." The amount paid in satisfaction of the judgment was recovered as the result of a transaction for dredging the Delaware River, a transaction entered into for profit, and was simply compensatory for work done. The fact that there was no net profit in the transaction is immaterial. The statute contemplates the inclusion in gross income of all receipts from business transactions and the deductions of all expenses incurred in connection therewith.

II

The respondent is not entitled to have the income in question computed on the method of long-term contracts provided in the regulations. Certain regulations of the Bureau of Internal Revenue do give contracting concerns certain options peculiar to long-term contracts, but the statute does not allow a taxpayer to make his return in accordance with these options unless its books are kept on that basis. The record here does not indicate that the taxpayer's books were kept on the basis of long-term contracts. Moreover, the taxpayer has never asserted the right to have its income computed according to the long-term contract method.

III

In the absence of a showing whether the respondent's return for 1920 was made on the cash or on the accrual basis, the Commissioner's determination should not be reversed unless it was correct on neither basis.

IV

The amount received in satisfaction of the judgment was taxable in 1920 on the cash basis as an amount actually received within that year.

V

The amount received in satisfaction of the judgment was taxable in 1920 on the accrual basis as an

amount accrued within that year. Liability on the respondent's claim was disputed and was doubtful until the decision of this Court in 1920. The amount received by the taxpayer consequently did not accrue until the judgment was obtained. This rule has been established by decisions of this Court in cases involving the question when a taxpayer may deduct as an expenditure the amount of a judgment, and we contend that the corresponding rule should be applied to the accrual of gross income.

VI

The decision of the court below is erroneous because it was based on an essential condition which that court had no authority to impose. Although this condition is in favor of the United States, we urge that it is not a proper one, and that the very fact of its inclusion in the decision of the Circuit Court of Appeals shows that that decision was erroneous.

ARGUMENT

I

THE SUM RECEIVED IN SATISFACTION OF THE JUDGMENT AGAINST THE UNITED STATES WAS PROPERLY A PART OF THE TAXPAYER'S GROSS INCOME

The Circuit Court of Appeals apparently held that the sum received in satisfaction of the judgment against the United States was not part of the respondent's income because it constituted simply a "reimbursement of loss." It would seem to be a necessary basis for this decision that the term

"gross income" as used in the Revenue Act relates only to profits, and that where a transaction does not result in a profit any amount received at the termination of the transaction represents recoupment of the expenses and should not, therefore, be included in gross income. We submit that there is no proper basis for this proposition, and that the sum received in satisfaction of the judgment was properly a part of the respondent's gross income.

The term "gross income" is defined in Section 213 (a) of the Revenue Act of 1918 (*infra,* pp. 27–28). This section provides that the term "gross income"—

> Includes gains, profits, and income derived from * * * professions, vocations, trades, businesses, * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

The contract for dredging the Delaware River was a transaction entered into for profit. The amounts received from the Government in the years 1913 to 1916 as payments under the express contract were unquestionably income, and apparently were treated as such by the taxpayer in its returns for those years. The amount paid in satisfaction of the judgment as the result of the decision of this Court is not of a different character from the amounts paid directly under the contract. Both were of the nature of compensation for work per-

formed. In its opinion in *United States* v. *Atlantic Dredging Co.*, 253 U. S. 1, affirming the judgment the proceeds of which are now in question, this Court said (p. 12):

> The Government makes the point, however, that the implication of the case is that bad methods were used, and insists that the implication makes the action one for a tort, and not tenable against the United States. We can not assent. There is no intimation of bad faith against the officers of the Government and the Court of Claims regarded the representation of the character of the material as the nature of a warranty; besides, its judgment is in no way punitive. It is simply compensatory of the cost of the work, of which the Government got the benefit.

Since the tax is levied and collected not on profits but on the "net income" of the annual period, the fact that there was no net profit in this transaction is immaterial in determining whether or not the amount of the judgment should be included in gross income. The amount of taxable net income, if any, depends upon the combined result of all of the taxpayer's operations for the taxable period, ascertained in the manner prescribed in the Revenue Act. Thus, Section 234 of the Revenue Act of 1918 (*infra*, pp 28–29) allows as deductions "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" as well as certain interest, taxes paid,

and allowances for depreciation. The taxpayer did take such deductions in its returns for the years 1913 to 1916, inclusive. If the statute contemplated that the taxpayer should include in its gross income only that part of its receipts, if any, which represented profits, there would have been no provision for the allowance of ordinary and necessary expenses and other deductions. These provisions make it clear that all receipts from ordinary business transactions are to be included in gross income and that the net income for any particular year is to be computed by deducting from those gross receipts the expenses and other deductions authorized by statute.

The fact that the judgment was against the Government and payment was made by the Government does not affect the case. It is not different, so far as the computation of the tax is concerned, from a judgment under a contract with a private person.

The taxpayer, although now contending that the money received under the judgment is not income at all, reported it as income for the years 1913, 1914, 1915, and 1916 in its amended returns filed after the receipt of the money, and its petition to the Board admits that it must in some way account for this as income. (R. 3–4.)

Although the Circuit Court of Appeals states that the money in question "is not income" (R. 22), its decision in effect requires it to be treated as income for the earlier years. That court relied

upon *Eisner* v. *Macomber*, 252 U. S. 189, and *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170.

We submit that nothing was decided in either of those cases which conflicts with our contentions. In the former case this Court held that Congress was not empowered by the Sixteenth Amendment to tax stock dividends as income. The definition of income (252 U. S. at p. 207) was formulated in order to distinguish income from capital and throws little, if any, light upon the instant problem.

In the latter case the taxpayer borrowed German marks before the War, and afterwards paid them back by the expenditure of a comparatively small sum on account of the change in the rates of exchange. It appeared that the taxpayer had lent all of the money which it borrowed to a subsidiary, of which it owned all of the stock, and that this subsidiary had lost all of the amounts advanced to it in business transactions. This Court held that the difference between the value of marks measured by dollars at the time of payment and the value when the loans were made to the taxpayer was not income. It said (p. 175):

> The transaction here in question did not result in gain from capital and labor, or from either of them, or in profit gained through the sale or conversion of capital. The essential facts set forth in the complaint are the loans in 1911, 1912, and 1913, the loss in 1913 to 1918 of the moneys borrowed, the excess of such losses over income by more than the item here in controversy,

> and the payment in the equivalent of marks greatly depreciated in value. The result of the whole transaction was a loss.
>
> * * * * *
>
> The contention that the item in question is cash gain disregards the fact that the borrowed money was lost, and that the excess of such loss over income was more than the amount borrowed. When the loans were made and notes given, the assets and liabilities of defendant in error were increased alike. The loss of the money borrowed wiped out the increase of assets, but the liability remained. The assets were further diminished by payment of the debt. The loss was less than it would have been if marks had not declined in value; but the mere diminution of loss is not gain, profit, or income.

But in the instant case the amount received under the judgment did result from work performed as part of a transaction entered into for profit, and it thus falls within the definition of gross income in the Revenue Act.

II

THE RESPONDENT IS NOT ENTITLED TO HAVE THE INCOME IN QUESTION COMPUTED ON THE METHOD OF LONG-TERM CONTRACTS PROVIDED IN THE REGULATIONS

The Circuit Court of Appeals, in its opinion (R. 22–23), quotes and relies on certain regulations of the Bureau of Internal Revenue relating to long-term contracts. These regulations are set out in the

Appendix, *infra*, pp. 31–33. They provide that in reporting the income derived from certain long-term contracts the taxpayer may (a) report all of the receipts and all of the expenditures made on account of a particular contract in the year in which the work is completed, or (b) report each year the percentage of the estimated profit on the basis of the percentage of expenditures.

These regulations must, of course, be read in the light of the statute under which they were promulgated. Section 212 (b) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064–1065, which was the Act in force during the calendar year 1920, provided that—

> The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income.

The provisions of Article 36 of Regulations 45, relating to long term contracts merely embody the recognition of the Commissioner that when a taxpayer's books are kept on the basis of long-term contracts, that basis does clearly reflect income, and may be used in reporting the taxpayer's income. But there is nothing in this regulation which allows a taxpayer to make his return on the long term

contract basis unless his books are kept on that basis. And, indeed, if the regulation had so provided, it would seem to be in conflict with the express provisions of the statute, which required that the computation "shall be * * * in accordance with the method of accounting regularly employed in keeping the books" of the taxpayer, unless that method does not clearly reflect income.

The record does not indicate that the taxpayer's books for the year 1920 were kept on the basis of long-term contracts. It is accordingly in no position to contend that its income for 1920 should be returned on that basis. Nor does the record furnish any basis for the return of this income on the long term contract basis for any other year.

The taxpayer has never asserted the right to have its income computed on the long-term contract basis. It does not appear that it prepared any of its returns upon that basis. Neither in its petition to the Board (R. 2–5) nor in its petition for review filed in the Circuit Court of Appeals (R. 16–18) did it assert the right to have the income computed upon this basis. It did not rely upon or mention the regulations in question either in the hearing before the Board or before the Circuit Court of Appeals.

Furthermore, where there are two methods of making an income-tax return, either one of which is legal and proper, and the taxpayer has made his return in accordance with one of these methods,

the taxpayer can not subsequently change to the other method and thereby become entitled to a refund. *Le Bolt & Co.* v. *United States*, 67 C. Cls. 422. And, we submit, in the absence of any action on the part of the taxpayer, it is not proper for the court to compute the income upon a basis different from that which the taxpayer has selected.

In any event it is clear that the taxpayer has not complied with the conditions upon which the regulations permit the use of the long-term contract method. Under the first of the two options indicated by these regulations, all income and deductions are deferred until the contract is completed. Here it is clear that the taxpayer did not defer reporting all these items. The record indicates that both receipts and disbursements on account of this contract were reported in the returns for the years 1913 to 1916. (R. 3, 9.) Under the second of the options allowed by the regulations, the taxpayer is required to make an estimate of the percentage of profit and a computation of income each year upon the basis of that part of the estimated expenses incurred during the year. It does not appear that this taxpayer ever made such an estimate or attempted to report its income and deductions on that basis. Moreover, the regulations providing for this option require that the taxpayer file amended returns upon the completion of the contract in case the estimates have been incorrect. Here it appears that the taxpayer stopped work

on the contract in 1915 (R. 8), but it did not then attempt to file any amended returns and did nothing about the matter until 1920 when it received the amount of the judgment. (See R. 4.)

III

IN THE ABSENCE OF A SHOWING WHETHER THE RESPONDENT'S RETURN FOR 1920 WAS MADE ON THE CASH OR ON THE ACCRUAL BASIS, THE COMMISSIONER'S DETERMINATION SHOULD NOT BE REVERSED UNLESS IT WAS CORRECT ON NEITHER BASIS

The Board of Tax Appeals made no finding as to the basis upon which the taxpayer filed its return for 1920 and the record does not show whether this return was filed on a cash receipts and disbursements basis or on an accrual basis.[1] Consequently the Commissioner's determination was properly approved by the Board if his action was justified either on the assumption that the taxpayer's return was made on the cash basis or on the assumption that it was made on the accrual basis. In a suit to recover a tax the determination of the Commissioner is *prima facie* correct. *Wickwire* v. *Reinecke*, 275 U. S. 101; *United States* v. *Rind-*

[1] The taxpayer filed as an exhibit to its petition before the Board of Tax Appeals a letter from the Commissioner of Internal Revenue and a statement which accompanied the letter. (R. 5–6.) In this statement the following language was used (R. 6): "You are advised that the bureau holds that the income from a judgment accrues to the taxpayer when a final determination has been made." But we do not believe that any significance can be attached to this language in the absence of any finding by the Board of Tax Appeals.

skopf, 105 U. S. 418. The burden rests upon the taxpayer to prove all the facts necessary to establish the illegality of the Commissioner's determination. *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357,361; *Botany Mills* v. *United States*, 278 U. S. 282; *Reinecke* v. *Spalding*, 280 U. S. 227. The rule is the same in an appeal to the Board. *Avery* v. *Commissioner*, 22 F. (2d) 6 (C. C. A. 5th); *Austin Co.* v. *Commissioner*, 35 F. (2d) 910 (C. C. A. 6th). Since the taxpayer has not shown upon what basis its return was filed, it can not prevail if the Commissioner's action was justified on either basis.

IV

THE AMOUNT RECEIVED IN SATISFACTION OF THE JUDGMENT WAS TAXABLE IN 1920 ON THE CASH BASIS AS AN AMOUNT RECEIVED WITHIN THAT YEAR

The findings of the Board of Tax Appeals show that the amount of the judgment was paid in 1920. (R. 9.) Section 213 (a) of the Revenue Act of 1918 (*infra*, pp. 27–28) provides that—

> The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

This section requires that the items of gross income shall be reported for the year in which re-

ceived, when the taxpayer's return is made on the basis of cash receipts and disbursements. It is well settled that compensation for services rendered or work done must be reported as gross income for the year in which received, regardless of the year in which the work was performed. *Edwards* v. *Keith,* 231 Fed. 110 (C. C. A. 2d); *Woods* v. *Lewellyn,* 252 Fed. 106 (C. C. A. 3d); *Jackson* v. *Smietanka,* 272 Fed. 970 (C. C. A. 7th).

V

THE AMOUNT RECEIVED IN SATISFACTION OF THE JUDGMENT WAS TAXABLE IN 1920 ON THE ACCRUAL BASIS AS AN AMOUNT ACCRUED WITHIN THAT YEAR

If the taxpayer's return for 1920 was made on the accrual basis, the sum in question accrued in 1920 and should have been returned by the taxpayer in that year. The judgment of this Court affirming the judgment of the Court of Claims in favor of the taxpayer was entered on April 26, 1920. (R. 9.) The liability of the United States upon the respondent's claim was not established until the decision of this Court in 1920. Until then the Government contested liability and maintained this position until the decision of this Court to the contrary. Until that time both the question of liability and the question of the amount recoverable were uncertain. It is significant that two of the five judges of the Court of Claims and two of the Justices of this Court dissented from the

decision that there should be a recovery. The plaintiff in the Court of Claims sued for an amount greatly in excess of that which was ultimately recovered. (See pp. 2–3, *supra.*) There was considerable doubt as to the legal basis for recovery. See dissenting opinion of Campbell, C. J., 53 C. Cls. 490, 505. Regardless of the basis for recovery, the income did not accrue until after the disputes as to liability and as to damages were settled. This would be true if, as indicated by this Court, the recovery was for breach of warranty and in the nature of compensation for work performed, and *a fortiori* it would be true on the basis apparently taken by the Court of Claims (53 C. Cls. 490, 504), that the recovery was for damages caused by the misrepresentation by officers of the United States.

In *Lucas* v. *American Code Co.*, 280 U. S. 445, this Court decided that an expense, on account of damages for discharge of an employee, which was not finally established until the entry of a judgment did not accrue until the year in which the judgment was entered. The Court said (p. 449):

> Generally speaking, the income tax law is concerned only with realized losses, as with realized gains. *Weiss* v. *Wiener*, 279 U. S. 333, 335. Exception is made, however, in the case of losses which are so reasonably certain in fact and ascertainable in amount as to justify their deduction, in certain circumstances, before they are absolutely real-

> ized. As respects losses occasioned by the taxpayer's breach of contract, no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test.

See also *Columbus Plate & Window Glass Co.* v. *Miller,* 38 F. (2d) 509 (S. D. Ohio). Although these cases related to deductions we see no reason why the rule is not equally applicable to the question of when an item of gross income accrues.

A similar case is *Lewellyn* v. *Electric Reduction Co.,* 275 U. S. 243. In that case the taxpayer in 1918 contracted to purchase tungsten ore and paid a draft which was to be applied against the purchase price of the first carload of ore shipped. Only a small quantity of ore was ever shipped. A balance was due the taxpayer of more than $27,000, to recover which suits were instituted by the taxpayer in 1919. The suits were terminated in 1922 without any recovery by the taxpayer. It thereupon filed an amended income-tax return for 1918, claiming the $27,000 as a loss in 1918. This Court held that the loss could not be deducted in that year, since it did not become certain that there would be a loss until the litigation was terminated in 1922. See *Highland Milk Condensing Co.* v. *Phillips,* 34 F. (2d) 777 (C. C. A. 3d), certiorari denied, 280 U. S. 608. See also *United States* v. *White Dental Co.,* 274 U. S. 398; *Lucas* v. *Ox Fibre Brush Co.,* 281

U. S. 115. Conversely, we submit, an item of gross income which is contested, and which is not finally determined until the entry of a judgment, does not accrue until the judgment is entered—at least if there is serious doubt as to whether the amount will be recovered.

A practical objection to the allocation to prior years of income later acquired through the entry of a judgment after litigation is the question of limitations. The final determination of compensation in cases similar to the instant case might well be delayed until after the statute of limitations has run as to the collection of the tax for the year to which the income would be allocated if it should be held that the income accrued in the years in which the work was performed. The only way in which the statutory limitation could be avoided would be by advance assessments based on guesswork, which are not authorized by statute.

The following language of the dissenting opinion in the court below seems to us convincing (R. 27):

> * * * Let it be supposed that the petitioner instead of losing during the four years involved, and recovering in the one year, had lost in one year, and had recovered on doubtful claims in four different years subsequently, certainly upon recovery in each of the four years the Government could not be required to go back and reform the tax assessment for the one year in which the loss was incurred, or four different times. To hold this would be to hold that the assess-

ment of taxes by the Government would never be completed for any given year, and would bring about a situation that would be chaotic.

* * * * *

The fact, that the losses were made and reported over a period of four years and the recovery had in one year worked to the financial disadvantage of the petitioner, is merely an incident. It might have worked to his advantage. In any event, the whole tax collection system of the Government can not be upset or changed to meet the exigencies of a particular case. One rule must be laid down for all, and Congress has seen fit to lay down the rule that the year is the unit, and we can see no reason for disregarding the rule.

VI

THE DECISION OF THE COURT BELOW IS ERRONEOUS BECAUSE IT WAS BASED UPON AN ESSENTIAL CONDITION WHICH THAT COURT HAD NO AUTHORITY TO IMPOSE

The Circuit Court of Appeals ordered that the amount received under the judgment should be eliminated from the computation of taxable income for the year 1920 upon condition that the taxpayer file amended returns for the years 1913 to 1916, eliminating the deductions claimed on account of the loss which was reimbursed. We maintain that the Circuit Court of Appeals had no authority to consider and determine any question directly affecting the taxpayer's liability for the years 1913 to 1916. The Board of Tax Appeals has jurisdic-

tion only as to years in which the Commissioner has determined a deficiency. Section 274 (g) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 56, provides:

> The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

See *Wolf Mfg. Co.* v. *Commissioner*, 10 B. T. A. 1161; *Blackstone* v. *Commissioner*, 12 B. T. A. 456.[2] The Board accordingly entered no order of redetermination as to the years 1913 to 1916, for the reason, among others, that it had no power to do so. (R. 14.) The jurisdiction of the Circuit Court of Appeals on the petition to review the decision of the Board of Tax Appeals can hardly be broader than the jurisdiction of the Board,[3] and consequently the

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[2] Before the passage of the Revenue Act of 1926 the Board did have jurisdiction as to years for which the Commissioner had determined no deficiency. *Appeal of E. J. Barry*, 1 B. T. A. 156; *Appeal of Hickory Spinning Co.*, 1 B. T. A. 409. See *Blair* v. *Oesterlein Machine Co.*, 275 U. S. 220, 225. But this jurisdiction was taken away by the Revenue Act of 1926, and the limitations of that Act applied to appeals which were filed before its passage. *Appeal of Cornelius Cotton Mills*, 4 B. T. A. 255; *Appeal of W. H. Morefield*, 4 B. T. A. 394.

[3] See Section 1003 of the Revenue Act of 1926, pp. 30–31, *infra*.

Circuit Court of Appeals had no power to order the filing of amended returns as to the years 1913 to 1916. Since this order was an essential part of the judgment below, we contend that that judgment can not stand.

We recognize, of course, that the condition which was imposed in the judgment of the Circuit Court of Appeals is in favor of the Government, but we urge that the condition is not a proper one, and that the very fact of its inclusion in the decision of the Circuit Court of Appeals shows that that decision was erroneous.

But if we are in error as to the question of the jurisdiction of the Circuit Court of Appeals over the years 1913 to 1916, nevertheless that court's adjustment for those years can be justified only on the theory that the amount of the judgment accrued in those years. The loss on the contract which the returns for those years deducted arose because of the fact that the expenses incurred under the contracts exceeded the amount received. If, therefore, these losses—an excess of expenditures over receipts— are to be eliminated, it can only be on the theory that there is additional income to apply against them. The amount of the judgment was obviously not income actually received until 1920. It follows, therefore, that if it is to be applied against the expenditures incurred during 1913 to 1916 as it has been under the decision of the Circuit Court of Appeals, it must be treated as

income which accrued during those years. But, as we have contended above the amount realized on the judgment did not accrue until 1920, in which year the liability was determined and the judgment was entered; nor is there anything in the record to show that this taxpayer made its return on an accrual basis in the years in question. The decision of the Circuit Court of Appeals is, therefore, we submit, erroneous.

CONCLUSION

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
CLAUDE R. BRANCH,
SEWALL KEY,
ANDREW D. SHARPE,
Special Assistants to the Attorney General.
ERWIN N. GRISWOLD,
Attorney.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue,
PREW SAVOY,
Special Attorney,
Bureau of Internal Revenue,
Of Counsel.

NOVEMBER, 1930.

APPENDIX

STATUTES

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064, 1065, 1077, provides in part:

TITLE II.—INCOME TAX

* * * * *

PART II.—INDIVIDUALS

* * * * *

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, busi-

nesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period * * *.

PART III.—CORPORATIONS

* * * * *

SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213 * * *.

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services

actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness * * *;

(3) Taxes paid or accrued within the taxable year * * *;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income * * *;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

[The extracts of subparagraphs (2), (3), and (6) given above are by no means complete. All that we have attempted to do is to indicate the general nature of the deductions allowed. Other classes of deductions are also specifically provided for in subparagraphs (8) through (14).]

The Revenue Act of 1926, c. 27, 44 Stat. 9, 55, 56, 110, provides in part:

SEC. 274. (a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer

may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. * * *

(b) If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * *

(g) The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

SEC. 1003. (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in section 239 of the Judicial Code, as amended); and the

judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

REGULATIONS

Article 121 of Regulations 33 (Revised), promulgated January 2, 1918, under the Revenue Acts of 1916 and 1917, provided as follows:

ART. 121. *Contracting corporations.*—Corporations engaged in contracting operations and which have numerous uncompleted contracts, which in some cases run for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work—that is, on jobs which have been finally completed—any and all moneys received in payment for completed jobs will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from gross income should be limited to the expenditures made on account of such completed contracts.

Income on basis of estimates.—Or the percentage of profit from the contract may be estimated on the basis of percentage of completion and payments made thereon, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the ex-

penses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year; all under or over statements of income to be adjusted upon completion of the contract and return made accordingly. (T. D. 2161.)

In cases wherein contracts are fully performed in one year, although payment therefor may be deferred until the next, the income resulting from the performance of the contract shall be returned for the year in which it was actually earned and determined.

Article 36 of Regulations 45, promulgated April 19, 1919, under the Revenue Act of 1918, provided:

ART. 36. *Long-term contracts.*—Persons engaged in contracting operations, who have uncompleted contracts, in some cases perhaps running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from such gross income should include and be limited to the expenditures made on account of such completed contracts. Or the percentage of profit from the contract may be estimated on the basis of percentage of expenditures, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that

is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. Upon the completion of a contract if it is found that as a result of such estimate or apportionment the income of any year or years has been overstated or understated, the taxpayer must file amended returns for such year or years. See section 212 of the statute and articles 22–24.

U. S. GOVERNMENT PRINTING OFFICE: 1939

FILE COPY

No. 31

In the Supreme Court of the United States

OCTOBER TERM, 1929

ROBERT H. LUCAS, COMMISSIONER OF INTERNAL REVENUE, Petitioner

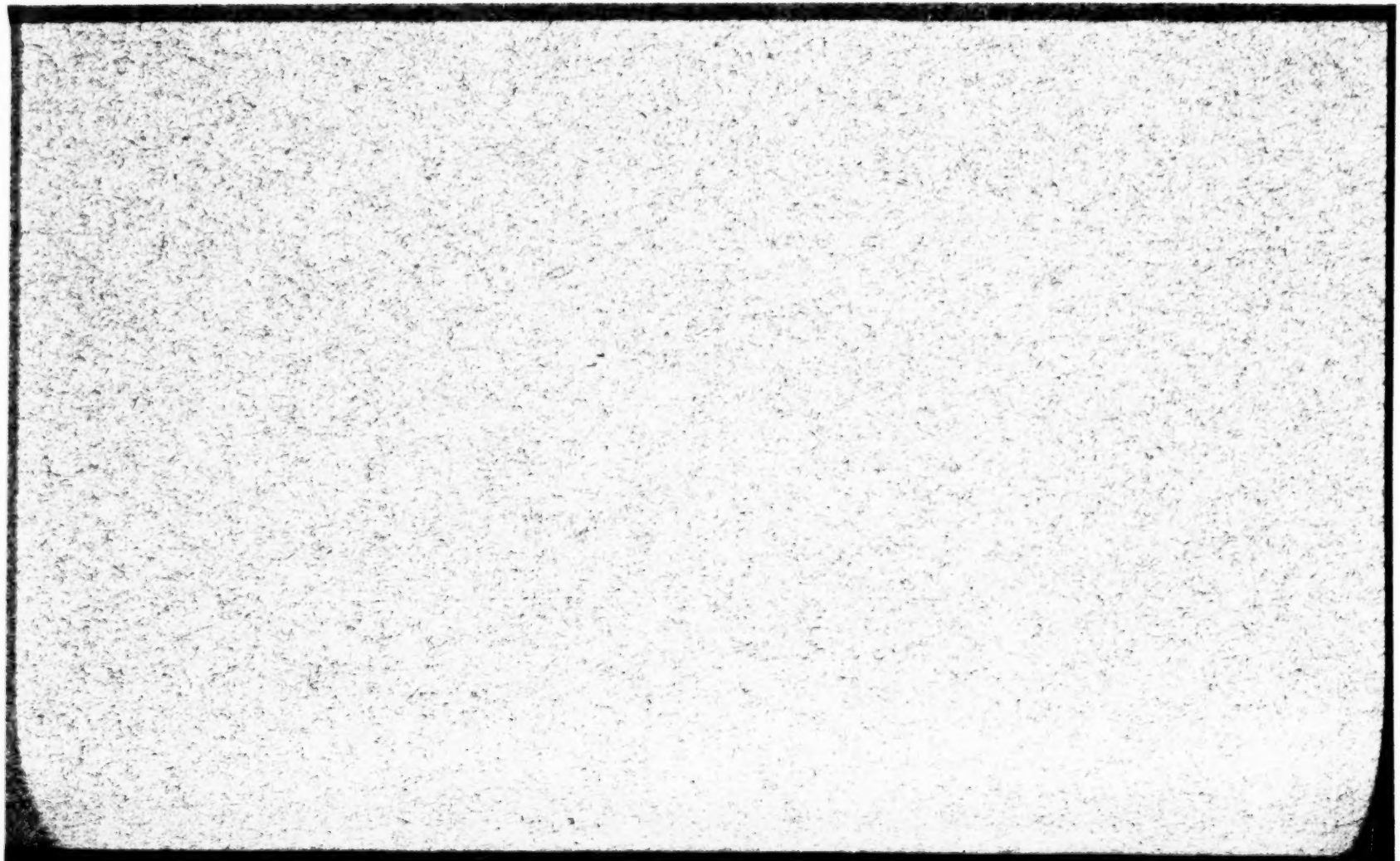
v.

SANFORD & BROOKS COMPANY

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

King Bros., Inc., Printers, 208 N. Calvert St., Baltimore, Md.

CHARLES McH. HOWARD,



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v.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals (R. 30-36) is reported in 35 F. (2d) 312. The opinion of the United States Board of Tax Appeals (R. 11-21) is reported in 11 B. T. A. 452.

STATEMENT OF FACTS

The Respondent, as agent for the Atlantic Dredging Company, under a contract with the United States Government, was engaged in dredging a part of the Delaware River during the years 1913, 1914, 1915 and 1916: it expended, in those years, in doing the work, a total of $176,271.88 in excess of the payments re-

ceived for the same, the amount of said excess, allocated to those years (1913 to 1916) on the basis of excess of expenditures made over payments received in each year, being as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89
Total	$176,271.88

These amounts constituted losses, that is to say, the expenditures by the Respondent made incident to the performance of the work exceeded the amount paid for doing the work. Until 1916, the Respondent assumed that the losses which it had made in performing the work aforesaid, had been sustained because of its having taken an unprofitable contract. In 1916, however, it learned that certain representations which had been made on behalf of the Federal Government, on the strength of which the contract was accepted, had been misleading: it promptly discontinued the work and instituted suit in the Court of Claims against the United States, to recover the amount of the loss so sustained by it in the performance of the contract, as well as damages.

The Court of Claims found that the expenditures made in the performance of the contract had amounted to $211,050.00 more than the Respondent had received in payment for the work, which amount the Court allowed to the Claimant (Atlantic Dredging Co. vs. United States, 53 C. Cls. 490 [R. 13]): on appeal to this Court, the judgment of the Court of Claims was affirmed (United States vs. Atlantic Dredging Co., 253 U. S. 1 [R. 13]) and there was accordingly paid to the

Taxpayer in 1920, the amount of the judgment rendered in its favor, with interest thereon amounting to $16,305.71, a total paid of $227,355.80. The Atlantic Dredging Company was entitled and there was paid to it $34,778.21, making the net amount received by the taxpayer $192,577.59 (R. 13).

The interest allowed, $16,305.71, was clearly taxable income for the year 1920 in which year it was received and it was reported as such; deducting this sum from the amount received by the taxpayer as aforesaid, left a balance of $176,271.88 which it received.

This amount the Respondent did not include in its return for 1920, but after the receipt of the same, it filed its amended returns for the years 1913, 1914, 1915 and 1916 to give effect to the reimbursement (R. 14, 6, 4).

The Commissioner of Internal Revenue held that the entire sum received by the Respondent, $192,577.59 and which was paid to it pursuant to the judgment, was income for 1920 (R. 12). The Respondent took an appeal to the Board of Tax Appeals which upheld the finding of the Commissioner (R. 21-22); it then appealed to the Circuit Court of Appeals for the Fourth Circuit (R. 22), which reversed the decision of the Board of Tax Appeals, holding that the amount of the judgment, exclusive of interest, which interest the Taxpayer had accounted for as income for 1920, did not constitute taxable income and remanded the case with directions that upon the filing of amended returns for the years 1913 to 1916, eliminating the deductions therein claimed on account of the loss which had been reimbursed, the amount received in reimbursement should be eliminated from the computation of income of the Respondent for the year 1920; the

decision held further that the item of interest $16,305.71 should be included in the computation of income for the year 1920; this had already been done by the Respondent in its return for that year (R. 30-34).

QUESTIONS PRESENTED

The Petitioner avers—

(a) that the Circuit Court of Appeals erred in holding that the amount of the judgment, exclusive of interest, received by the Respondent in 1920, should be excluded from the Taxpayer's gross income for that year, and

(b) that said Court likewise erred in directing that the decision of the Board of Tax Appeals holding the amount of the judgment received to be income for the year 1920, should be reversed provided the Respondent amends its returns for the years 1913 to 1916, and eliminates the deductions therein claimed on account of the loss which it had sustained and for which it was reimbursed by the payment of the judgment, the Petitioner contending that by so doing, the Court decided questions directly affecting tax liability for those years and that on the record it had no power so to do.

The last two errors are specified separately in the petition.

The Petitioner assigns as reasons for granting the writ, the following:

1st. that the Circuit Court of Appeals "has apparently laid down the principle that the term 'gross income' as used in the revenue laws relates only to profits" and this, Petitioner asserts is error;

2nd. that as the record is silent as to whether the Taxpayer for the year 1920, reported on a cash basis or on an accrual basis, the Commissioner's action in determining the amount of the judgment to be taxable income for 1920 was *prima facie* correct and should have been approved.

This contention assumes, of course, that the amount received was taxable income in some year, although it was held by the Circuit Court of Appeals to be non-taxable income for any year; and

3rd. that no one of the years 1913 to 1916 was involved in the appeal of the Respondent to the United States Board of Tax Appeals or in the Board's redetermination of the finding of the Commissioner and that the Circuit Court of Appeals, therefore, had no authority to "consider and decide questions affecting" the years 1913 to 1916, inclusive.

STATUTE INVOLVED

Revenue Act of 1918, Section 213, as follows:

"The term 'gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

The definition above quoted is substantially the same and identically the same for the purposes of the

petition and this answer, as that contained in the Acts of 1913, 1916 and 1917 [Revenue Act of 1913, Section B; Revenue Act of 1916, Section 2A(d), and Revenue Act of 1917, Section 1201(1)].

ARGUMENT

The Circuit Court of Appeals did not expressly or impliedly assert that gross income as used in the Revenue Law related only to profits and the Petitioner is in error in so stating. The finding of the Court was that as "income, even gross income, within the meaning of the taxing acts, is not synonymous with receipts", and as the amount of the judgment paid under the decision of this Court was "simply compensatory of the cost of the work of which the Government got the benefit" that the amount received under the judgment was "in reimbursement of loss" and that that being the case, the amount of it did not represent a gain derived from capital, labor, or from any other source and, therefore, was not taxable (R. 30-31).

Quoting the decision of this Court in Eisner vs. Macomber, 252 U. S. 189, the Circuit Court of Appeals simply held that the amount in question "was not gain derived from capital, from labor, or from both combined". Manifestly, this is correct; the petitioner was no better off financially after receiving the money than it was before it had made the payments which were reimbursed to it by the payment of the judgment.

What has been said applies as well to the second as to the first ground assigned by the Petitioner for the granting of the writ.

As a third reason for the request for the writ, the Petitioner asserts that as none of the years 1913 to 1916 were involved in the appeal to the Board of Tax Appeals, the Circuit Court of Appeals had not authority to consider and decide questions affecting the years 1913 to 1916, inclusive. In the "Findings Of Fact" of the Board of Tax Appeals (R. 14), the Board found that the Respondent had filed amended returns asking that the amount of the judgment be treated as income for the years 1913 to 1916, inclusive; it did not make a determination of tax liability with respect to those years it is true, but found the entire amount of the judgment to be income for the year 1920 and taxable as such. Neither can the decision of the Circuit Court of Appeals be construed as a redetermination of the taxes for those years. The decision is simply that the taxpayer could not get the benefit of the saving in taxes resulting from the loss sustained in 1913 to 1916, inclusive and yet retain the amount paid it in reimbursement of the loss or be permitted to retain the amount paid to it and yet get the benefit through a saving of taxes for the years 1913-1916, of the failure of the Government to pay the obligation.

CONCLUSION

We submit that the instant case involves no special or important reason for the granting of the writ prayed for and that the petition should be denied.

HARRY N. BAETJER,
Attorney for Respondent.

CHARLES McH. HOWARD,

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DEC 1 1930

No. 31

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

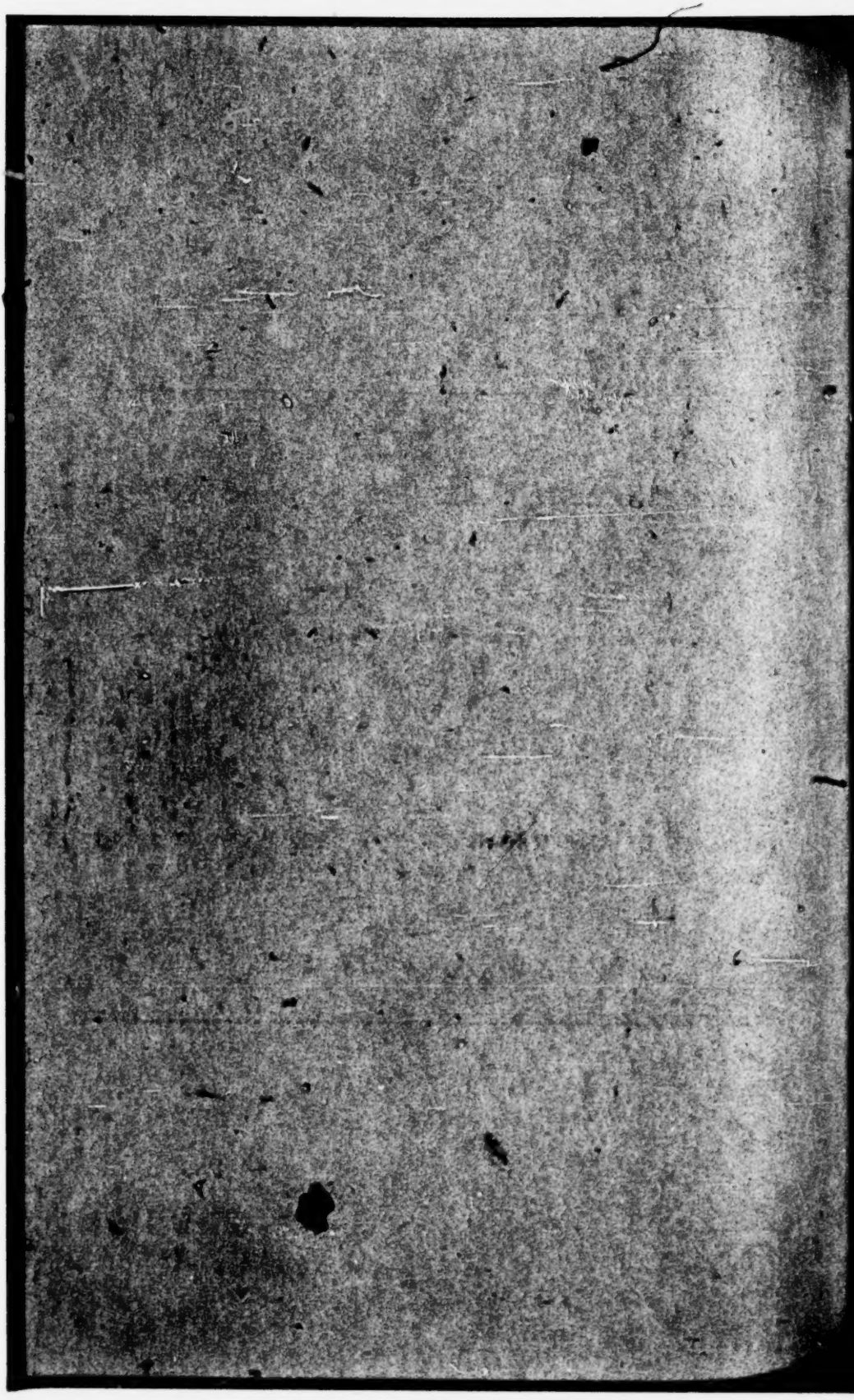
DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

v.

SANFORD & BROOKS COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR THE RESPONDENT.



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SANFORD & BROOKS COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

Opinions Below.

The opinion of the Circuit Court of Appeals (R. 20-25) is reported in 35 F. (2d) 312. The opinion of the Board of Tax Appeals (R. 8-14) is reported in 11 B. T. A. 452.

Jurisdiction.

The judgment of the Circuit Court of Appeals (R. 28) was entered October 18, 1929. The petition for a writ of *certiorari* was filed January 16, 1930, and was granted March 3, 1930 (R. 29-30), 281 U. S. 707. The jurisdiction of this Court rests on Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statutes Involved.

The statutes and regulations involved are set forth in the Appendix, *infra,* p. 21.

Question Presented.

Should there be included in its taxable income for the year 1920, the amount received by the respondent during that year, in payment of a judgment in its favor against the United States, the amount of which judgment represents the difference between the amount of expenditures made by the respondent in the performance of a contract with the United States and the amount theretofore paid to it, the amount of the judgment including no profit, but being simply compensatory of the cost of the work done of which the Government got the benefit?

Summary of Argument.

I.

The XVI Amendment to the Constitution authorizes the collection of taxes on income only and no statute or regulation fixing the method of arriving at taxable gain is valid if it results in making taxable something which is not income.

II.

This Court, the lower courts and the Board of Tax Appeals have defined income as and the definition of income as used in common speech means, "gain" as distinguished from reimbursement of a loss.

III.

The Revenue Act cannot make subject to tax that which is not gain, by requiring that it be considered as gross income and that its character as taxable or non-taxable, be dependent upon whether or not there are deductions permitted from gross income which would exhaust the item in question, that is to say, an item, which does not represent net

income subject to tax cannot be made taxable by any requirement of the statute that it be considered gross income in the first instance, regardless of what the real character of the item may be.

IV.

The fact that the taxpayer in arriving at its liability for taxes for the years 1913, 1914, 1915 and 1916 deducted from its gross income the amount of the losses which were refunded as a result of the payment of the judgment, cannot change the character of the payment received in 1920 and if that payment is not taxable it cannot be made so because of the fact that failure to tax it, on account of limitations or for any other reason, results in giving to the taxpayer a reduction in the amount of its taxes to which it is really not entitled, by virtue of its having made the deduction of losses, in the earlier years.

V.

That since the jurisdiction of the Circuit Court of Appeals for the Fourth Circuit, to render a decision requiring that amended returns be filed for the years 1913-1916 eliminating the deduction claimed in those years in aggregate amount equal to the amount of the judgment, was raised for the first time in the petition for writ of *certiorari*, this Court should refuse to consider it.

VI.

That Section 274 (g) of the Act of 1926 is not applicable to the instant case and the Circuit Court of Appeals did have jurisdiction to render its decision directly affecting tax liability for the years 1913 to 1916.

ARGUMENT.

I.

Income Only Can Be Taxed.

Federal income taxes are levied solely under the authority so to do conferred upon Congress by the XVI Amendment to the Constitution; it gives the power

> "to lay and collect taxes on incomes, from whatever source derived * * *."

To the extent that the taxing statutes and the regulations passed pursuant to the provisions thereof, impose a tax on money or property as income, which is not a realized addition to the taxpayer's property, they are unconstitutional.

The money received in payment of the judgment, which the Government contends is subject to tax was not paid to respondent in accordance with the terms of the contract between it and the United States but represented a reimbursement by the Government of the amount which had been expended by the taxpayer for work and presumably also for materials, of which the Government got the benefit; if during the year 1920, the taxpayer having ceased to operate, had had no deductions from gross income, then if the contention of the Government is correct, the taxpayer would be assessed on money that represented no addition to its capital, no gain, no profit but simply a return of money or capital, the amount of which it had had and had expended and which pursuant to the judgment was being returned to it; such a condition can arise only when the work is done and expenditures are made during one accounting (tax) period and the reimbursement is made in another such period.

The character of the payment in the case at bar is not we submit, income subject to tax.

II.

Income Implies Gain.

Differences between the Government and taxpayers as to what constitutes income, have been presented for decision to this Honorable Court and to the lower courts in cases so numerous and so varied as to the facts presented, as to preclude quotations from them except in only a few instances in which the questions of law presented were most apposite to those presented in the case at bar. These would seem to be—

(a) Eisner v. Macomber, 252 U. S. 189 (1919);
(b) Doyle v. Mitchell Bros. Co., 247 U. S. 179 (1918);
(c) Inland Products Co. v. Blair, 31 Fed. (2d) 867 (1929);
(d) Bowers v. Kerbaugh-Empire Co., 271 U. S. 170 (1926).

The facts in the two cases first cited are in no sense analogous to those in the case at bar, but in the other cases, the analogy is close; in all the cases, however, the meaning of the term "income" as used in the XVI Amendment is defined; in these cases the holding was:

Eisner v. Macomber, at page 207:

> "For the present purpose, we require only a clear definition of the term 'income' as used in common speech, in order to determine the meaning in the Amendment."
>
> "Income may be defined as the gain derived from capital, labor, or from both combined."

Doyle v. Mitchell Bros. Co., at pages 184 and 185:

> "Whatever difficulty there may be about a precise and scientific definition of 'income', it imports as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities."

Inland Products Co. v. Blair:

In this case taxes on products manufactured by it were paid in 1919 and 1920; in 1924 the amount paid was refunded as having been collected erroneously and without warrant of law. *Held*, that the amount refunded was not to be added to the corporate income of the petitioner for the year in which it was received but that its "Returns" for the years 1919 and 1920 in which the amount paid had been deducted, should be restated for the purpose of eliminating the deductions.

We submit that there is no distinction in principle, between the return of taxes improperly paid to the Government and the refund of the amount of moneys expended for its account and which it was required to refund.

Finally, as to the cases above cited, Bowers v. Kerbaugh-Empire Co. is so much in point as to the facts as to be, we submit, conclusive of the case at bar. In this case, the taxpayer, a corporation, owned all of the capital stock of a second company, Kerbaugh, Inc., a corporation engaged in the contracting business. To finance the operations of the subsidiary, the taxpayer borrowed from a German bank in the years 1911 to 1913, inclusive, certain moneys for which it issued its promissory notes payable in marks. The funds borrowed were lost in their entirety by the subsidiary in the conduct of its business during the years 1913, 1914, 1916, 1917 and 1918; the loss in each of these years was allowed as a deduction in the income tax returns of the subsidiary. In 1921, the taxpayer paid in full the claim held against it by the German bank, the settlement, due to the depreciation in value of the marks, amounting to $684,456.18, less than the amount borrowed, in dollars. The Government contended that the saving constituted income for the year 1921; on appeal to this Honorable Court, it was held that the amount saved due to the depreciation of the mark, was not income but was a mere diminution of loss; the opinion held, at p. 175—

> "The contention that the item in question is cash gain disregards the fact that the borrowed money was

lost, and that the excess of such loss over income was more than the amount borrowed. When the loans were made and the notes given, the assets and liabilities of defendant in error were increased alike. The loss of the money borrowed wiped out the increase of assets, but the liability remained. The assets were further diminished by payment of the debt. The loss was less than it would have been if marks had not declined in value; but the mere diminution of loss is not gain, profit or income."

The same thought was succinctly put in an income tax case, construing the word "income" as used in the Eng-151, 164, in which Lord MacNaughten observed that a person is liable for income taxes—

"not on what saves his pocket, but on what goes into his pocket."

Tennant v. Smith, A. C. 151.

It is submitted that no material distinction can be drawn between the instant case and that of Bowers v. Kerbaugh-Empire Co. The Board of Tax Appeals in passing upon the case at bar, contended that the cases were distinguished because in the latter case, the Court was dealing with the liquidation of liabilities for a smaller sum in dollars than the face amount thereof, which at best could be called negative income, whereas in the instant case, it was dealing with positive income, the receipt of money. We submit that this begs the question; what is not income cannot be made so by calling it such. The payment in the instant case was not made pursuant to the contract, it was not made on a *quantum meruit* basis and it involved no payment of profit, the amount of the payment being simply the difference between expenditures made for doing the work and the amount theretofore paid on account of those expenditures, this Court holding in its opinion that the judgment was in no way punitive but that it was simply compensatory of the cost of the work, of which the Government got the benefit; to return the cost of work can mean only the return

of money paid out, the return of that which the taxpayer had before it was expended for the account of the Government.

Counsel for the Government has attempted to distinguish this case in his brief in the support of his petition for writ of certiorari, page 17, as follows:

> "In the instant case there was a transaction arising out of the operation of a business where compensation was collected for work performed in earlier years, the expenditures made in performing the work having been properly deducted in those years. In the Kerbaugh-Empire Co. case the whole transaction was a capital transaction."

The amount of the judgment was not payment in compensation for work performed: the Kerbaugh case involved no more a capital transaction than the instant case. The money borrowed from the German bank became upon its receipt, an asset in the form of cash; when the amount was lost, the loss was an operating one and reduced the assets just as in the instant case. In both cases capital was affected only in so much as a corporate operating loss is finally reflected in the decreased value of capital assets.

Other illustrative cases although not so clearly in point are—

(a) Marshall v. The Commissioner of Internal Revenue, 10 B. T. A. 1140 (1928);
(b) United States v. Supplee-Biddle Co., 265 U. S. 189 (1924);
(c) Merchants L. & T. Co. v. Smietanka, 255 U. S. 509 (1920).

In its petition to this Honorable Court for certiorari, the Government insists that inasmuch as the amount of the judgment was paid for work performed, the payment is identically the same as the payments made under the contract at unit prices fixed therein; this is a manifest error, the judgment represents no payment at unit prices and was

in no sense a payment made pursuant to the contract which provided for payment at a fixed price per cubic yard of earth removed.

United States v. Atlantic Dredging Co., 253 U. S. 2.

Certainly until capital expended in any transaction has been made good, the transaction cannot yield a profit and what is not a profit as t o a single transaction cannot be converted into a profit by lumping that transaction with others had by the taxpayer.

Merchants L. & T. Co. v. Smietanka, 255 U. S. 509.

If the taxpayer in the instant case, had been a copartnership and a partner had withdrawn at the end of 1916 and had been paid his pro-rata share of the assets of the company, the claim against the Government which resulted in the judgment, the amount of which it is sought to tax in this case, being at that time unknown to any of the partners, could it be seriously contended that the retiring partner would not share in the amount recovered in 1920, an amount which was due in 1916 although it was not at that time known to any of the partners, and could the interest of the retiring partner be depleted by charging against the recovery on an asset which was in existence when he retired, losses incurred four years later through the operation of a partnership in which he had at the time no interest; yet if the amount of the judgment is income for the year in which received, for tax purposes, it should be income for all purposes in the absence of a special agreement relating to it.

III.

No Requirement as to Method of Establishing Income Subject to Tax Can Convert a Reimbursement Into a Gain.

The contention of the Government is based entirely on the wording of Sections 213, 232, 233, and 234(a) of the Revenue

Act of 1918. We submit the strict wording of these sections does not justify the conclusion for which it contends.

Section 213 provides that gross income shall include gains, profits and income derived from salaries, wages or compensation for personal services * * * from professions, vocations, trades, businesses, commerce or sales * * * also from the transaction of any business carried on for gain or profit, or gains and profits or income derived from any source whatever; that the amount of such items shall be included in the gross income for the taxable year in which received, subject to certain exceptions not material as to this case.

Section 234(a)(1) provides that corporate income shall be subject to deductions for expenses incurred in carrying on the corporate trade or business, for interest and taxes paid, losses sustained and not compensated for, debts ascertained to be worthless and charged off, the amount of dividends received from a corporation which is taxable and reasonable allowance for exhaustion, wear and tear and obsolescence.

No system of bookkeeping or requirement as to the manner or method of arriving at taxable gain, however clearly set forth and provided by statute, can convert into income that which is in fact not income; nor can money be made subject to tax by statutory requirement that it be included in gross income of the taxpayer, if it would not be taxable were it net income, that is to say, if it would not be taxable if it constituted the sole receipt of the taxpayer during the year in question and if during that year the taxpayer was entitled to no deduction from gross income.

If the contention of the Government is correct, then it must admit this to be true; if in 1920, the respondent had ceased operations, had reduced its capital to a nominal sum, had no employees or expenses of any kind, except only such expenses as are incident to the maintenance of its corporate existence, such as annual franchise taxes and the like, and had disposed of every asset it had and had then received the amount in question, the entire amount subject only to the payment of nominal franchise taxes, would have been

net income and the taxpayer would have been taxed on the entire amount of it, notwithstanding the fact that it represented only the return to it of moneys that it had expended; no possible construction or requirement of the statute as to method of arriving at taxable income, can justify such a finding.

Had there been no misunderstanding between the Government and the contractor and the amount that was paid in 1920 had been paid as it had been expended by the taxpayer in 1913, 1914, 1915 and 1916, the amount paid would have exactly off-set the expenditures to refund which it was decreed to be paid; the taxpayer would have been no better off and no worse off than if the expenditures had never been made, the amount of the payment would never have been net income subject to tax; by withholding the payment, by mere lapse of time, it is contended by the Government that what was not net income has been made such.

IV.

Estoppel Cannot Prevail Against Respondent.

Nor can the fact that the amount of expenditures made and subsequently refunded as operating charges, reduced the income of the taxpayer for the years 1913, 1914, 1915 and 1916 and changed its liability for taxes from what it would have been had the refunds been made, require the taxpayer to account for the money when subsequently received as in the case of a bad debt charged off and later recovered. Until after 1916, the taxpayer had no knowledge of the existence of the indebtedness of the Federal Government to it and the charging off of the amounts expended and subsequently refunded was in no sense analogous to the charging off of a bad debt. The only debts which are permitted to be charged off under the act, are

> "debts ascertained to be worthless and charged off within the taxable year."

No amount of money can be deemed to be charged off as a debt when the person charging it off does not claim that

it is due to him by any one and does not recognize its existence as a debt. No such charge off was made by the taxpayer. (Findings of Fact, B. T. A., Record, page 9.)

Moreover and finally, we submit, that whatever the taxpayer did with reference to the amount expended and subsequently refunded, in the years 1913, 1914, 1915 and 1916 cannot change the character of the receipt in 1920. If the amount of the judgment has been properly paid to the taxpayer, then the amount of it was due in 1913, 1914, 1915 and 1916 and the taxpayer was in error in deducting the amount of it in arriving at its net income subject to tax and the charging off of the same was due to a mistake on its part, as well as on the part of the Government. Properly the mistake should be corrected but that is all; it cannot be adjusted through permitting the mistake to persist and attempting to correct it by changing the nature of the amount repaid. The deduction should not have been made in the earlier years and the taxpayer has filed amended returns to eliminate the deductions; if for any reason, lapse of time, or otherwise, additional taxes for the earlier years cannot be collected which might be found due upon correction of the mistakes, it is not an answer to substitute for taxes thus uncollectible as a result of a given transaction, something different. We respectfully submit that the amount of the payment is not income.

V.

Jurisdictional Question Cannot Be Raised.

We submit that if it be conceded that the Circuit Court of Appeals did determine tax liability of the respondent for the years 1913, 1914, 1915 and 1916 or re-determined such liability and that it was without jurisdiction so to do and if it be conceded also that through lapse of time or for some other reason, it will not be possible for the Government to collect taxes which might be found due upon a restatement of the returns for those years, eliminating as deductions the loss which has been reimbursed

through the payment of the judgment, all of these facts would still not justify the finding that the amount of the judgment was income for the year 1920.

> "the fact that a taxpayer has paid lower taxes for prior years than those which were rightfully due, because of erroneous computations of taxable income, and that the statute of limitations now bars the assessment and collection of any deficiency for those years, does not justify an erroneous computation of its tax liability for any subsequent year."
>
> Appeal of Macmillan Co., 4 B. T. A. 251, 253 (1926).

Inasmuch, however, as the jurisdiction of the Circuit Court of Appeals to determine any question directly affecting the respondent's liability for taxes for the years 1913 to 1916 was not advanced by the Government, except as one of the bases urged by it for the grant of *certiorari*, this Court should not consider the question.

> "* * * This Court sits as a court of review. It is only in exceptional cases coming here from the federal courts that questions not pressed or passed upon below are reviewed."
>
> Duignan v. United States, 274 U. S. 195, 200 (1927).

In Blair vs. Oesterlein Machine Co., 275 U. S. 220 (1927), this Court decided what we submit is the exact question here presented in favor of the contention that we have just advanced. The Machine Company paid taxes for 1918, 1919 and 1920; the returns for the three years were considered as an entirety by the Commissioner who reduced the taxes in one year, increased them in another and found a net deficiency; the company filed an appeal with the Board of Tax Appeals which issued a subpoena to compel the Commissioner to answer certain interrogatories; he denied the authority of the Board on the ground that no appeal could be taken from any determination made by him under the sections of the Revenue Act involved and that,

therefore, the Board of Tax Appeals was without jurisdiction. The Supreme Court of the District of Columbia in a proper case, directed the Commissioner to obey the subpoena of the Board of Tax Appeals which decree of the lower Court was affirmed by the Court of Appeals of the District of Columbia. The Commissioner in an application for *certiorari* specified as error to be urged, only his original contention as to the lack of jurisdiction of the Board of Tax Appeals; *certiorari* was granted and the Commissioner then for the first time, suggested that as no deficiency had been found for one of the years under consideration, the Board of Tax Appeals was without jurisdiction to determine tax liability as to that year. This Court held that it sits as a court of review and would not consider the second issue raised by the Commissioner.

At page 225 of the report of the case, Mr. Justice Stone delivering the opinion, said:

> "We think the question suggested is not properly before us. It was not specifically raised on the record before the Board or either court below and, so far as appears, was not considered by any of them. We were asked to grant *certiorari* only to pass upon the question whether the Commissioner's determinations under P. 327 and P. 328 may be appealed to the Board of Tax Appeals. This Court sits as a court of review. It is only in exceptional cases, and then only in cases from the federal courts, that questions not pressed or passed upon below are considered here. Duignan vs. United States, 274 U. S. 195. There are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the government. Hence we do not pass upon this aspect of the case with respect either to the return or the amended return for 1918, and our decision is without prejudice to the disposition of the question wherever appropriately presented."

It is true that in the instant case, the jurisdiction was questioned in the petition for certiorari which was not true in the case from which the above citation was made. The distinction, however, is not material, this Court expressly holding that the question was not properly before it and that it was only in exceptional cases that questions not passed upon below are considered.

In another case, however, Saltonstall v. Birtwell, 164 U. S. 54, 70 (1896), error of the Circuit Court was first claimed upon petition for certiorari. This Court held that where there was no assignment of error in the trial court and the question was not considered in the Circuit Court of Appeals it was not incumbent upon this Court to consider it even though raised in the petition for writ of certiorari. In the opinion at page 70, the Court said:

> "* * * Nor do we consider it incumbent on us to consider whether there was error in the Circuit Court, as a matter of practice, in directing judgment upon the special findings in favor of the importer. No such error was assigned in the Circuit Court, or was considered in the Court of Appeals, but it first appeared in the application for the writ of certiorari."

We are not unmindful of the decision of this Court in Green County v. Thomas' Executor, 211 U. S. 598 (1909). It is submitted, however, if this Court finds that the amount of the judgment was not income for the year 1920 as contended by the Government, that no substantial right could be served by reversing the decision of the Circuit Court of Appeals on the ground that although its finding was correct that there was no tax due, its decision should be reversed nevertheless because of the fact that it held the respondent liable for additional taxes for the years 1913 to 1916, although it was without jurisdiction so to do.

VI.

Jurisdiction of Circuit Court of Appeals.

The Government in its petition for *certiorari* assigned as error the fact that the Circuit Court of Appeals had considered and decided—

> "questions directly affecting tax liability for the taxable years 1913 to 1916, when such taxable years were not involved in the taxpayer's petition to the Board of Tax Appeals";

and in its brief, in support of the petition, maintained that under Section 274(g) of the Revenue Act of 1926, the jurisdiction of the Board of Tax Appeals was limited so that it could determine facts for years other than 1920, only to the extent required for a correct determination of the taxpayer's liability for 1920 and that it was prohibited under the aforementioned section of the Act, from finding an overpayment or underpayment for those years.

There was no such restriction on the jurisdiction of the Board of Tax Appeals in the Revenue Act of 1924. The Government in its brief, page 24, admits that—

> "Before the passage of the Revenue Act of 1926 the Board did have jurisdiction as to years for which the Commissioner had determined no deficiency."

We submit that the appeal in the instant case is governed by the provisions of the Revenue Act of 1924 and that Section 274(g) of the Act of 1926 is not applicable. The proceedings in the matter of the appeal as to dates, are as follows:

> June 22nd, 1925, letter from the Bureau to the taxpayer, advising of the finding of a deficiency (R. p. 5);
>
> November 17th, 1925, formal notice to the taxpayer of the amount of the deficiency claimed. In this letter the Commissioner advises as follows (R. p. 5):

"In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals";

January 16th, 1926, appeal to the United States Board of Tax Appeals filed (R. p. 2);

February 23rd, 1926, answer of the Commissioner of Internal Revenue filed (R. p. 6).

The Act of 1926 by its terms, provided that it should take effect as of January 1, 1925, except as to Section 257 and Sections 271 to 285, inclusive, and that these sections should take effect upon the enactment of the Act; the Act was approved on February 26th, 1926.

Section 274 of the Act of 1926, therefore, became effective on February 26th, 1926, subsequent to the date of the filing of the appeal and of the answer.

The Act of 1926 provides:

Section 283(b):

"If before the enactment of this Act any person has appealed to the Board of Tax Appeals under subdivision (a) of Section 274 of the Revenue Act of 1924 (if such appeal relates to * * * so much of an income * * * tax imposed by any of the prior Acts enumerated in subdivision (a) of this section, Act of 1918 enumerated as was not assessed before June 3, 1924), and the appeal is pending before the Board at the time of the enactment of this Act, the Board shall have jurisdiction of the appeal. In all such cases * * * the jurisdiction of the Board and of the courts, shall be determined * * * in the same manner as provided in subdivision (a) of this section, except as provided in subdivision (j) of this section and except that the person liable for the tax shall not be subject to the provisions of subdivision (d) of Section 284."

Section 283(a):

"If after the enactment of this Act the Commissioner determines that any assessment shall be made in respect of any income * * * tax imposed by * * * the Revenue Act of 1918 * * * or by any such Act as amended, the Commissioner is authorized to send by registered mail to the person liable for such tax notice of the amount proposed to be assessed, which notice shall, for the purposes of this Act, be considered a notice under subdivision (a) of Section 274 of this Act. In the case of any such determination the amount which should be assessed * * * shall * * * be computed as if this Act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand and the provisions prohibiting claims and suits for refund) as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in Section 277 of this Act."

Section 283(j):

"In cases within the scope of subdivision (b) * * * of this section where any hearing before the Board has been held before the enactment of this Act and the decision is rendered after the enactment of this Act, such decision shall, for the purposes of this title, be considered to have become final upon the date when it is rendered and neither party shall have any right to petition for a review of the decision. * * *"

The instant case, therefore, comes within the provisions of Section 283(b) of the Act of 1926, providing—

(1) that "the Board shall have jurisdiction of the appeal," under Section 274(a) of the Revenue Act of 1924; and

(2) the questions of jurisdiction "shall be determined * * * in the same manner as provided in subdivision (a) of this section" (283).

Section 283(a) provides that the "amount which should be assessed * * * shall * * * be computed as if this Act had not been enacted."

Section 283(j) does not qualify the above since there was no "hearing" in the instant case before the Board of Tax Appeals prior to February 26th, 1926.

We submit, therefore, that Section 274(g) does not control the jurisdiction of the Board of Tax Appeals in the instant case and that there is no such limitation on the Circuit Court of Appeals as is contended for by the Government, but that it had jurisdiction to determine tax liability for the years 1913 to 1916.

Appeal of E. J. Barry, 1 B. T. A. 156 (1924);
Appeal of Hickory Spinning Co., 1 B. T. A. 409 (1925);
Appeal of Eagle Dye Works, 1 B. T. A. 638 (1925).

CONCLUSION.

Finally, it can scarcely be said with accuracy that the decision of the Circuit Court of Appeals did decide questions directly affecting tax liability for the years 1913 to 1916. The record shows that the respondent had filed amended returns, not as contended for by the Government, for the purpose of admitting that the amount of the judgment was income allocable to the years 1913 to 1916 but for the sole purpose of correcting a mistake in the returns for those years, by decreasing the amount of deductions claimed; whether the amendment took the form of an addition to income as originally reported or a diminution in the amount of deductions as so reported could not change the fact, namely, that the amount of the deductions was decreased by the amount of the refund. The Circuit Court of Appeals held that the amount of the judgment was income for 1920 but that being the fact, the deductions claimed in the earlier years were erroneous. We submit

that it had the right to pass on questions directly affecting tax liability for the previous years and that in any event, it was not a finding of tax liability but simply a holding that an admitted mistake should be corrected.

A very considerable argument is made in the brief for the Government as to whether the contract which gave rise to the expenditures which were refunded by the judgment, is a long term contract as defined in the income tax regulations and a very considerable argument is made dealing with whether or not the books of the taxpayer were kept on a receipt or accrual basis and whether the amount of the judgment should be accounted for as of the date received or as of the date accrued.

Both questions seem to us immaterial, the question being whether or not the payment is income. In this connection, it is well to realize that prior to 1916 books could not be kept on an accrual basis and income tax liability accounted for on that basis and that the judgment which established the right to the money was rendered, and the amount was paid in the same tax year.

We respectfully submit that the amount of the payment is not gain; it represents nothing but a return to the taxpayer of moneys that it had and had expended, and that no method prescribed by statute for the ascertainment of income subject to tax, can convert into gain what is not gain but the return of one's own moneys; that the Circuit Court of Appeals had authority to direct the correction of the mistakes made by the deductions in 1913 to 1916 of the losses the amount of which was refunded but that even if it had no such authority, its decision holding the amount of the judgment to be non-taxable income should be affirmed.

HARRY N. BAETJER,

Attorney for Respondent.

APPENDIX.

STATUTES.

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064, 1065, 1077, provides in part:

TITLE II.—INCOME TAX.

* * * * *

PART II.—INDIVIDUALS.

* * * * *

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in Section 213, less the deductions allowed by Section 214.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 213. That for the purposes of this title (except as otherwise provided in Section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business

carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of Section 212, any such amounts are to be properly accounted for as of a different period * * *.

PART III.—CORPORATIONS.

* * * * *

Sec. 232. That in the case of a corporation subject to the tax imposed by Section 230 the term "net income" means the gross income as defined in Section 233 less the deductions allowed by Section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of Section 212 or in Section 226.

Sec. 233. (a) That in the case of a corporation subject to the tax imposed by Section 230 the term "gross income" means the gross income as defined in Section 213 * * *.

Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness * * *;

(3) Taxes paid or accrued within the taxable year * * *;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income * * *;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

[The extracts of subparagraphs (2), (3), and (6) given above are by no means complete. All that we have attempted to do is to indicate the general nature of the deductions allowed. Other classes of deductions are also specifically provided for in subparagraphs (8) through (14).]

The Revenue Act of 1926, c. 27, 44 Stat. 9, 55, 56, 110, provides in part:

Sec. 274. (a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in Section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60- day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. * * *

(b) If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * *

(g) The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Sec. 1003. (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in Section 239 of the Judicial Code, as amended); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon *certiorari*, in the manner provided in Section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

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Supreme Court of the United States.

OCTOBER TERM, 1930.

No. 31

DAVID A. BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

SANFORD & BROOKS COMPANY.

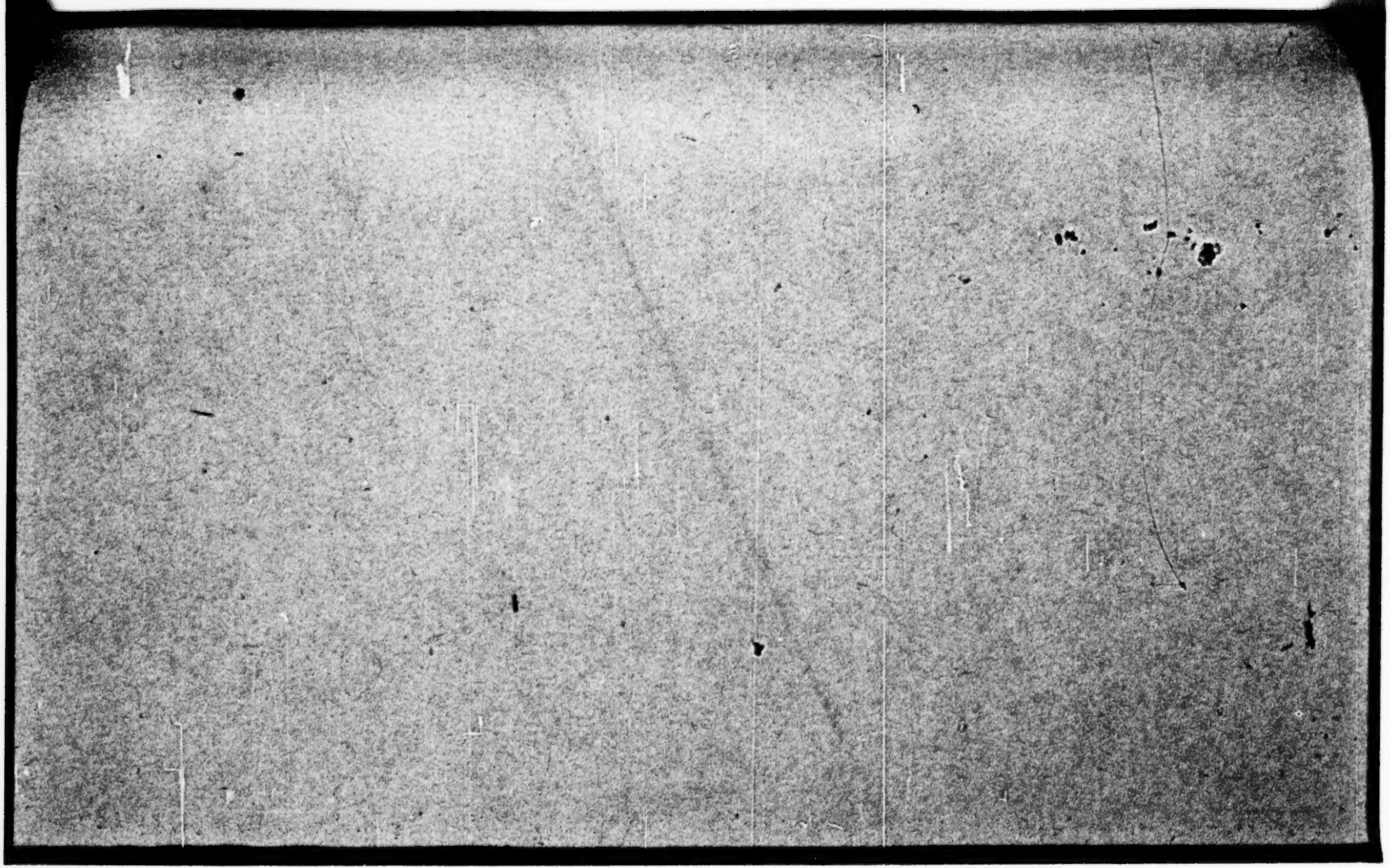
MOTION OF
CHARLES D. HAMEL, RICHARD S. DOYLE AND BRAINARD AVERY, FOR LEAVE TO FILE BRIEF AS *AMICI CURIAE*

AND

BRIEF AS *AMICI CURIAE*.

CHARLES D. HAMEL,
RICHARD S. DOYLE,
Washington, D. C.
BRAINARD AVERY,
New York, N. Y.

Of Counsel,
HAMEL & DOYLE,
Washington, D. C.
AVERY & WHITING,
New York, N. Y.



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SANFORD & BROOKS COMPANY.

MOTION FOR LEAVE TO FILE BRIEF AS *Amici Curiae.*

MAY IT PLEASE THE COURT:

The undersigned, as counsel for the firm of Crossman & Sielcken, a partnership in liquidation in the City of New York, State of New York, respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae.*

CHARLES D. HAMEL,
RICHARD S. DOYLE,
BRAINARD AVERY,
Counsel for Crossman & Sielcken, in Liquidation, as Amici Curiae.

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Should the amount of a judgment in 1920 representing the recovery of losses suffered in 1913, 1914, 1915 and 1916 be included in taxpayer's gross income for the purpose of determining its income tax liability for the year 1920? 2
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Supreme Court of the United States.

OCTOBER TERM, 1930.

No. 31

DAVID A. BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
v.
SANFORD & BROOKS COMPANY.

BRIEF
OF CHARLES D. HAMEL, RICHARD S. DOYLE, AND BRAINARD AVERY AS *AMICI CURIAE.*

PRELIMINARY STATEMENT.

In 1920 the taxpayer recovered and collected a judgment against the United States for a sum equal to the amount by which expenditures made during the years 1913 to 1916 in performance of a contract exceeded the compensation received under it in those years.

The question in the case is whether the amount of the judgment, which represents recoupment of loss in performance of the contract, constitutes income subject to tax under the Sixteenth Amendment.

Your petitioners are counsel for the firm of Crossman & Sielcken, a partnership in liquidation in New York City, which recovered in 1930, pursuant to a judgment of the District Court for the Southern District of New York, $380,000 capital which was lost in business in 1915. The question at issue in this case is of very great importance, because the decision of this Court may determine whether or not that amount should be included in gross income for 1930 under any of the

provisions of the Revenue Act of 1928 for the purpose of determining net income subject to income tax. It is therefore the desire of counsel to file a brief *amici curiae* on this question.

QUESTION PRESENTED.

Should the amount of a judgment in 1920 representing the recovery of losses suffered in 1913, 1914, 1915 and 1916 be included in taxpayer's gross income for the purpose of determining its income tax liability for the year 1920?

AMENDMENT TO THE CONSTITUTION AND STATUTES INVOLVED.

"AMENDMENT XVI.

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Revenue Act of 1918, c. 18, 40 Stat. 1057:

"SEC. 212. (a) That in the case of an individual the term 'net income' means the gross income as defined in section 213, less the deductions allowed by section 214.

"(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calender year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *"

"SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such

property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profits, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * * "

"SEC. 233(a) That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in section 213, except that: * * * "

ARGUMENT.

The facts in this case are set forth in the petition for writ of certiorari, but special attention is called to the following statement taken from the findings of fact of the Board of Tax Appeals, 11 B. T. A. 452, 453:

"The petitioner actually expended in the prosecution of the work the sum of $354,009.19. Prior to the recovery under the judgment of the court, petitioner had received from the Government on account of the work in question the sum of $142,959.10, making a difference between the amount expended and the amount received of $211,050.09, the amount recovered in the judgment. The part of this excess of expenditures over payments received, $176,271.88, which was applicable to the petitioner, related to the years 1913 to 1916 on the basis of the excess of expenditures over receipts in these years as follows:

1913	$28,241.03
1914	68,117.81
1915	69,705.15
1916	10,207.89
Total	$176,271.88"

The Board of Tax Appeals found as a fact that the $176,271.88 recovered in 1920 pursuant to the judgment of

the Court of Claims exactly equalled the excess expenditures actually disbursed by the taxpayer over and above the payments received from the Government. The facts in that respect as found by the Board are not questioned in this Court.

The decision of the court below in reversing the Board of Tax Appeals and holding that the amount collected under the judgment in question constituted a reimbursement of a loss sustained and as such was not taxable income is supported by and in harmony with the decisions of this Court in defining what is income within the meaning of the Sixteenth Amendment to the Constitution and the Revenue Statutes.

Section 212(a) of the Revenue Act of 1918 defines net income as gross income less the deductions allowed by the statute.

This Court in its decision in the case of *Eisner* v. *Macomber*, 252 U. S. 189, 207, 208, defined "income" under the Revenue Act of 1916 as follows:

> "After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of August 5, 1909 (Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 Sup. Ct. 136, 140 (58 L. Ed. 285); Doyle *v.* Mitchell Bros. Co., 247 U. S. 179, 185, 38 Sup. Ct. 467, 469 (62 L. Ed. 1054), 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle case, 247 U. S. 183, 185. 38 Sup. Ct. 467, 469 (62 L. Ed. 1054).
>
> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. '*Derived—from—capital;*' 'the *gain—derived—from—capital,*' etc. Here we have the essential matter: *not* a gain *accruing* to capital; not a *growth*

> or *increment* of value *in* the investment; but a gain, a profit, something of exchangable value, *proceeding from* the property, severed from the capital, however, invested or employed, and *coming in*, being '*derived*'—that is *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal—*that* is income derived from property. Nothing else answers the description.
>
> "The same fundamental conception is clearly set forth in the Sixteenth Amendment—'incomes, *from* whatever *source derived*'—the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution."

The theory that the words "gross income" are equivalent to "gross receipts" was advanced by the Government in the case of *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 183 and was rejected by this Court, Justice Pitney stating:

> "Starting from this point, the learned Solicitor General has submitted an elaborate argument in behalf of the government, based in part upon theoretical definitions of 'capital,' 'income,' 'profits,' etc., and in part upon expressions quoted from our opinions in Flint *v.* Stone Tracy Co., 220 U. S. 107, 147, 31 Sup. Ct. 342, 55 L. Ed. 389, Ann. Cas. 1912B, 1312, and Anderson *v.* Forty-two Broadway Co., 239 U. S. 69, 72, 36 Sup. Ct. 17, 60 L. Ed. 152, with the object of showing that a conversion of capital into money always produces income, and that for the purposes of the present case, the words 'gross income' are equivalent to 'gross receipts'; the insistence being that the entire proceeds of a conversion of capital assets should be treated as gross income, and that by deducting the mere cost of such assets we arrive at net income. The cases referred to throw little light upon the present matter, and the expressions quoted from the opinions were employed by us with reference to questions wholly remote from any that is here presented.
>
> "The formula that the entire receipts derived from a conversion of capital assets after deducting cost value must be treated as net income, so far as it is applied to a conversion of assets acquired before the act took effect and so as to tax as income any increased value that accrued before that date, finds no support in either the letter or the spirit of the act, and brings the former into

> incongruity with the latter. If the gross receipts upon such a conversion are to be treated as gross income, what authority have we for deducting either the cost or the previous market value of the assets converted in order to arrive at net income? The deductions specifically authorized are only such as expenses of maintenance and operation of the business and property, rentals, uncompensated losses, depreciation, interest, and taxes. There is no express provision that even allows a merchant to deduct the cost of the goods that he sells.
>
> "Yet it is plain, we think, that by the true intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income. * * *"

See also *United States* v. *Central Union Bank*, 10 Fed. 612; *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *United States* v. *Guggenheim Exploration Co.*, 238 Fed. 231, 237; and *Appeal of James P. McKenna*, 1 B. T. A. 326, 333.

This Court has always recognized the principle that in order to determine whether there has been a gain and the amount of the gain, if any, there must be withdrawn from the gross proceeds an amount sufficient to restore the capital value. See *Doyle* v. *Mitchell Bros. Co.*, *supra*. There is no essential difference in the nature of a transaction, or in the relation of the profit to the capital involved, whether the sale or conversion be a single, isolated transaction, or one of many. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 520.

In *Lucas* v. *Alexander*, 279 U. S. 573, 577, 73 L. Ed. 851, this Court, in determining whether or not the proceeds of certain life insurance policies constituted income under the Sixteenth Amendment, distinguished between an amount realized as a profit or gain upon premium investment in a policy, and an amount paid in the nature of an indemnity for, or repayment of, an economic loss suffered by the insured. The decision infers that amounts paid as an indemnity for, or repayment of, an economic loss would not be income to the insured.

Gain or profit is an essential element of income. *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, 175. In that case, this Court considered all the facts pertaining to the transaction

extending over a period of years, and concluded that the transaction as a whole resulted in a loss, Justice Butler stating:

> "The transaction here in question did not result in gain from capital and labor, or from either of them, or in profit gained through the sale or conversion of capital. The essential facts set forth in the complaint are the loans in 1911, 1912, and 1913, the loss in 1913 to 1918 of the moneys borrowed, the excess of such losses over income by more than the item here in controversy, and payment in the equivalent of marks greatly depreciated in value. The result of the whole transaction was a loss."

In the present case, the essential facts are that the taxpayer invested its capital throughout 1913, 1914, 1915 and 1916 in a losing contract; that the excess of such investments over the taxpayer's total contractual receipts was $176,271.88; that the taxpayer was reimbursed in 1920 in an amount exactly equal to the loss thus sustained. The result of the whole transaction was that the taxpayer was simply made whole with respect to a capital outlay. No gain, profit, or income was derived, either economically or within the sense of those terms as repeatedly defined by this Court.

The conclusion of the Court below that the transaction as a whole produced for the taxpayer no gain or profit taxable in any year is sound in fact and sound as a matter of law.

The Government has advanced the argument in the present case that these expenditures in the years 1913 to 1916 aggregating $176,271.88 were taken and allowed as deductions from gross income in the returns of the taxpayer for those years; furthermore that Section 212 prescribes a twelve months period for the determination of income, and that each taxable year stands alone with respect to items of income and deductions according to the events that transpire within that period. In our opinion, the question as to what deductions were taken or allowed in prior years' returns, or what entries were made on the books in those years, is not controlling in this issue. Income is a matter of fact—not of bookkeeping *Appeal of B. B. Todd, Inc.*, 1 B. T. A. 762, 767; *Cleveland Woolen Mills* v.

Commissioner of Internal Revenue, 8 B. T. A. 49. Books are only evidential, being neither indispensable nor conclusive. The decision must rest upon the facts. *Doyle* v. *Mitchell Bros. Co., supra.*

There can be no realization of gain or profit in this transaction until the capital of the taxpayer has been completely restored, even though it requires a period of years and a suit in the Court of Claims to accomplish that result. If the accounting has been deficient in prior years and the statutory period within which to make assessments of additional taxes for those years has expired, we can not see how that would affect the problem as to whether or not the $176,271.88 received in 1920 was income or a reimbursement of capital.

Section 212(b) prescribes that the net income shall be computed upon the basis of an annual accounting period of twelve months, in accordance with the method of accounting employed by the taxpayer. That section also provides that if the method employed does not clearly reflect the net income, then the Commissioner may prescribe a basis which does clearly reflect the income. The Commissioner's own regulations (Article 22 of Regulations 45), in interpretation of that section states:

> "The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income."

There is nothing in that provision of the statute, and nothing in the Commissioner's regulations, which supports the argument that items of income and deductions shall be determined according to the events of any particular taxable year. The express wording of the statute and the Commissioner's own regulations provide for a method of accounting on a basis which clearly reflects income, and if a transaction extends over a period of years, then the income from that transaction shall be reported in the taxable year in which it is realized, that is when the profit is received or accrued. In the present

case, that could not possibly be until the amount of the payments received exceeded the expenditures. In other words, the event that gives rise to taxable income must be one that creates a realization of income.

There are any number of transactions that start in one year and end in another, and the income, if any, is reflected on the books of account in the proper month or year, according to the date of realization. Bookkeeping and accounting methods have been devised and approved by the Government for properly reflecting such income. See Article 36 of Regulations 45, 62, 65 and 69, with reference to reporting income from long-term contracts, and Articles 42, 43, 44 and 45 of Regulations 45, 62, 65 and 69 pertaining to the sale of property on the installment plan. But in no case do we understand that the time or date of realization of income is controlled by the method the taxpayer employs in entering the figures on his books or on his returns. *Appeal of B. B. Todd, Inc., supra.*

The question of what is income has been confused by the Bureau with the deductions allowed by statute for losses. The fact that a capital item recovered was once allowed as a deduction from gross income as a loss does not make that item income. Deductions from income, such as losses, interest, expenses, taxes or other charges, are statutory. They are allowed as deductions from income according to and under the conditions prescribed by the statute, and only in the year in which the loss occurred. *John H. Farish & Co.* v. *Commissioner of Internal Revenue*, 31 Fed. (2d) 79, 7 A. F. T. R. 8540, *Lewellyn* v. *Electric Reduction Company*, 275 U. S. 243.

The Department has permitted, and in many cases required by regulation that taxpayers file with the Collector amended income and profits tax returns correcting errors made in returns for prior years. See Article 36 of Regulations 45, 62, 65 and 69, Article 111 of Regulations 45 and 62, and Article 112 of Regulations 65 and 69. (For other rulings see footnote.)

Amended returns have been permitted or required: Where through wrong accounting practice capital charges have been made to income, *O. D. 113, 1 C. B. 234;* where a corporation issued its bonds at a discount and improperly charged the

The Government in this case has laid great stress on the fact that the taxpayer deducted these expenditures from gross income in its returns for 1913 to 1916. The deduction of a loss on a return in a prior year does not create income by estoppel in a later year when the loss is recovered. That event simply signifies that when the apparent loss was incurred, the best judgment of the parties deemed it irreparable. Actually, subsequent events proved it to be wrong—proved that the loss was reparable. Whatever basis this might afford for retroactively adjusting the situation, in view of subsequent experience (*Inland Products Company* v. *Blair*, 31 Fed. (2d), 867), there is certainly no basis for attempting in the current

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discount to profit and loss, *O. D. 111, 1 C. B. 224;* where errors have been made in valuing inventories, *T. B. M. 31, 1 C. B. 55; T. B. R. 48, 1 C. B. 47; A. R. M. 38, 2 C. B. 54;* where corporations have erroneously taken deductions for donations to the American Red Cross, *Mim. 2207, 1 C. B. 221;* where adjustments have been made to the income of railroad corporations for transactions in prior years, pursuant to instructions of the Interstate Commerce Commission, and such income was erroneously taken up on the books of the corporation during the taxable year, *O. D. 9, 1 C. B. 58;* where the taxpayer has in the past exercised the option of reporting profit on installment sales as at the date of sale and later wishes to change to a basis of reporting the profit on such sales as realized as at the date of collection, amended returns were permitted by ruling, *O. D. 623, 3 C. B. 105; O. D. 567, 3 C. B. 108; Mim. 3170, III-1 C. B. 107;* where returns have been made upon an improper accounting basis, *O. D. 684, 3 C. B. 80;* where a corporation claims additional invested capital because of the excess in value of certain assets over the value at which they were carried on the corporate books, amended returns may be filed for each year for which an erroneous return has been made, both before and subsequent to March 1, 1913, *O. D. 901, 4 C. B. 391;* where taxpayers in preparing returns have used appreciated or inflated values, *T. D. 3243, 5 C. B. 289;* where a guardian has misappropriated funds, the minor may file amended returns showing the loss, *A. R. M. 144, 5 C. B. 139;* where capital expenditures have been erroneously charged to expense, *I. T. 1347, I-1 C. B. 370;* where a stockholder of a corporation was required to pay back a part of the distribu-

year a readjustment under perhaps radically different conditions because of a mistake in deductions in former years. In short, a mistake in judgment as to irreparability of a loss, and an error in claiming deductions, do not create an estoppel and manifestly do not transmute into income what would otherwise not be regarded as income. For instance, let us suppose the cases were as follows: The taxpayer sustained a loss in performing his contract with the United States, but the best legal talent was of the opinion that he had a good claim against the United States for the amount of the loss. The claim is admitted a year or two later by the United States, and delay is made in payment. Under those circumstances the tax-

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tion in liquidation, *I. T. 1164, I-1 C. B. 17;* where annuity payments have been erroneously claimed as deductions from income, *I. T. 1484, I-2 C. B. 66;* where permission is granted the taxpayer to change the method of taking deductions for bad debts under the Revenue Act of 1921, *I. T. 1615, II-1 C. B. 98; I. T. 1774, II-2 C. B. 144;* where separate returns may be filed by husband and wife under the community property laws, *Mim. 3201, III-1 C. B. 346; I. T. 2133, IV-1 C. B. 202;* where certain excise taxes were erroneously accrued and claimed as deductions in prior years, *I. T. 2081, III-2 C. B. 97;* where income has been reported on the long-term contract basis under Art. 36 of Regs. 62, 65, 69 and Art. 334 of Regs. 74, and it is found upon completion of the contract that the net taxable income arising thereunder has not been clearly reflected for any year or years; where taxpayers in computing income from a business have subtracted excessive amounts for redemption of trading stamps, Art. 91 of Regs. 62, 65, 69 and Art. 335 of Reg. 74; where in any case in which it is found that the deductions for depreciation and depletion taken between March 1, 1913, and December 31, 1915, by taxpayers engaged in the oil and gas industry, are not reasonable, Art. 226, Regs. 62, 69; Art. 228, Reg. 65, and Art. 246, Reg. 74; where there is only one legal and proper method of making a return, the taxpayer has erroneously made his return upon some other method, then, even though the return has been accepted and the tax paid, he may file an amended return correcting the error, and if this return shows an overpayment, he is entitled to a refund, decision of the Court of Claims, *Lebolt & Co.* v. *United States,* April 1, 1929, VIII-2 C. B. 247-8.

payer's deduction on his return would be denied and the subsequent recovery would not be included in income. It would be recognized that he was simply reducing a claim for reimbursement to possession. This is not a disposition of the claim giving rise to income.

Are we constrained to reach a different result, if the administrative officials in charge for the United States deny the validity of the claim in the first instance and thus compel a suit?

Whether a deductible loss is sustained may be made to turn on the difference between an admission or denial (*Lucas* v. *American Code Company*, 280 U. S. 445), but certainly whether money received in the current year is a gain derived from capital, labor or both combined, does not depend on the admission or denial in the previous years of the validity of a claim. To so hold would upset fundamental conceptions of the function of juristic institutions even such as this Honorable Court. Judge Learned Hand so aptly pointed out that judgments do not establish rights, they only declare them, *Commissioner of Internal Revenue* v. *Marshall Field*, 42 Fed. (2d) 820, 823:

> "* * * All that happened was that Field and the trustees got into a dispute about the meaning of the will; and Field succeeded in getting the court to take his view. We can not for that reason say that the court's action changed what had all along been his rights; it did not create them; he had them already. We do not of course forget that a disputed right is not for practical purposes an available right at all; or that in fact Field was helpless until the decree passed. Nevertheless, we can not take the judgments of a court as creating property without confusing their function, and substituting juristic metaphysics for those conventions on which in the end most of the law stands. * * * We can not make over fundamental notions in the interest of a more searching theoretic analysis."

The subsequent judgment and payment in this case did not create rights; it declared rights which already existed. The

administrative officers denied them but that did not affect the existence of the rights. When merged in a judgment, when paid for in cash, they were no different than if their validity had been admitted in the first instance. The only difference is that in the first instance, the Government would have insisted that the taxpayer could not claim a loss on his return since for his loss he had a valid claim. Obviously, the Government officials with their eye on consistency could not say that there was a valid claim for income tax purposes and at the same time deny the validity of the claim for the purpose of payment. The errors were obviously errors of the Government officials, but if corrected at this time, it should not be by distorting fundamental concepts of income and a series of mental gymnastics involving a plea of a new kind of "estoppel."

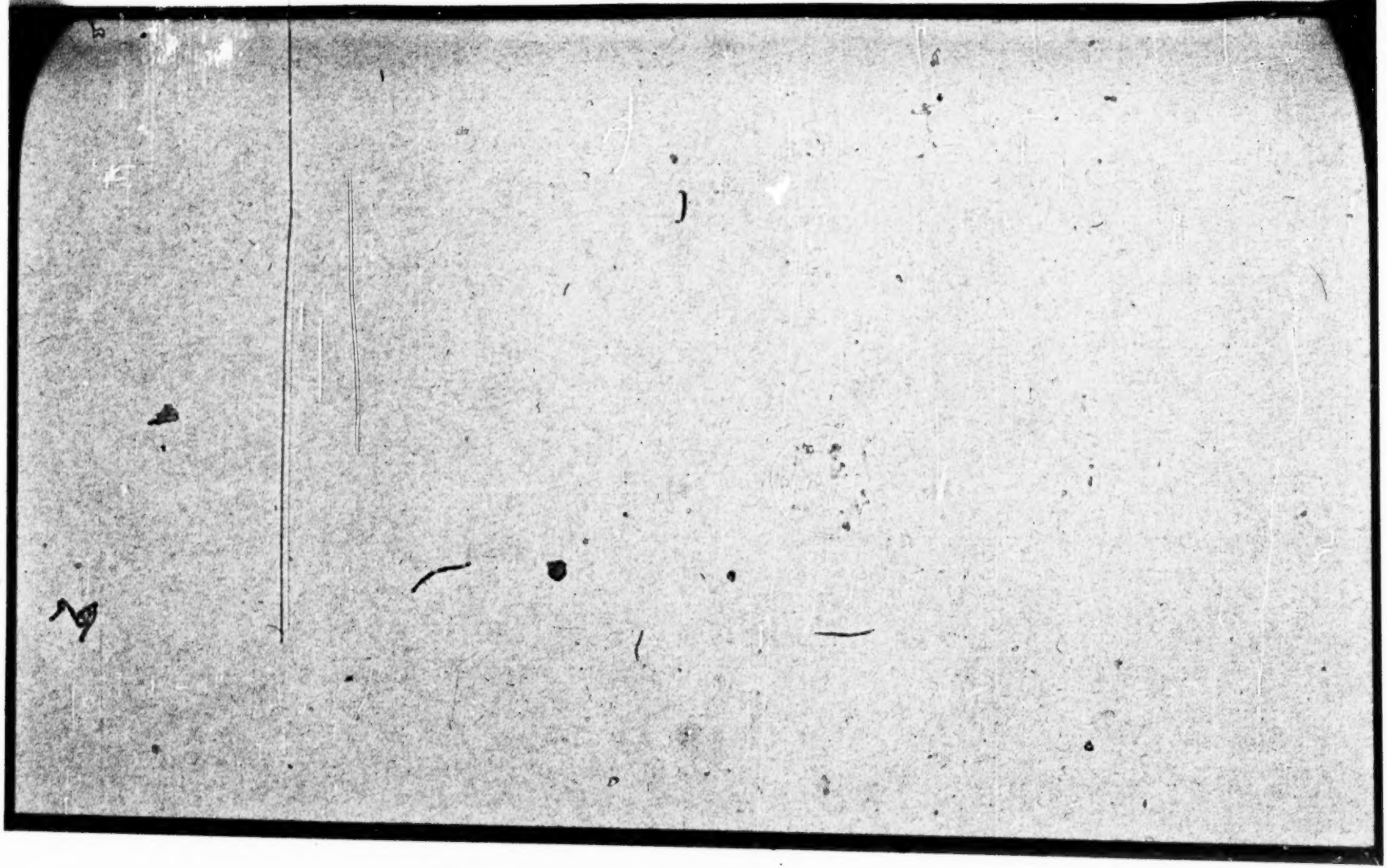
In this connection, we should call attention to *Rice, Barton & Fales, Inc.* v. *Commissioner*, 41 Fed. (2d) 339. That presented a case of gratuitous diminution of a loss suffered in a transaction by the taxpayer. The court held, through Judge Wilson, that the case is similar to this case with the added feature of gratuity, stating that "income is not synonymous with receipts."

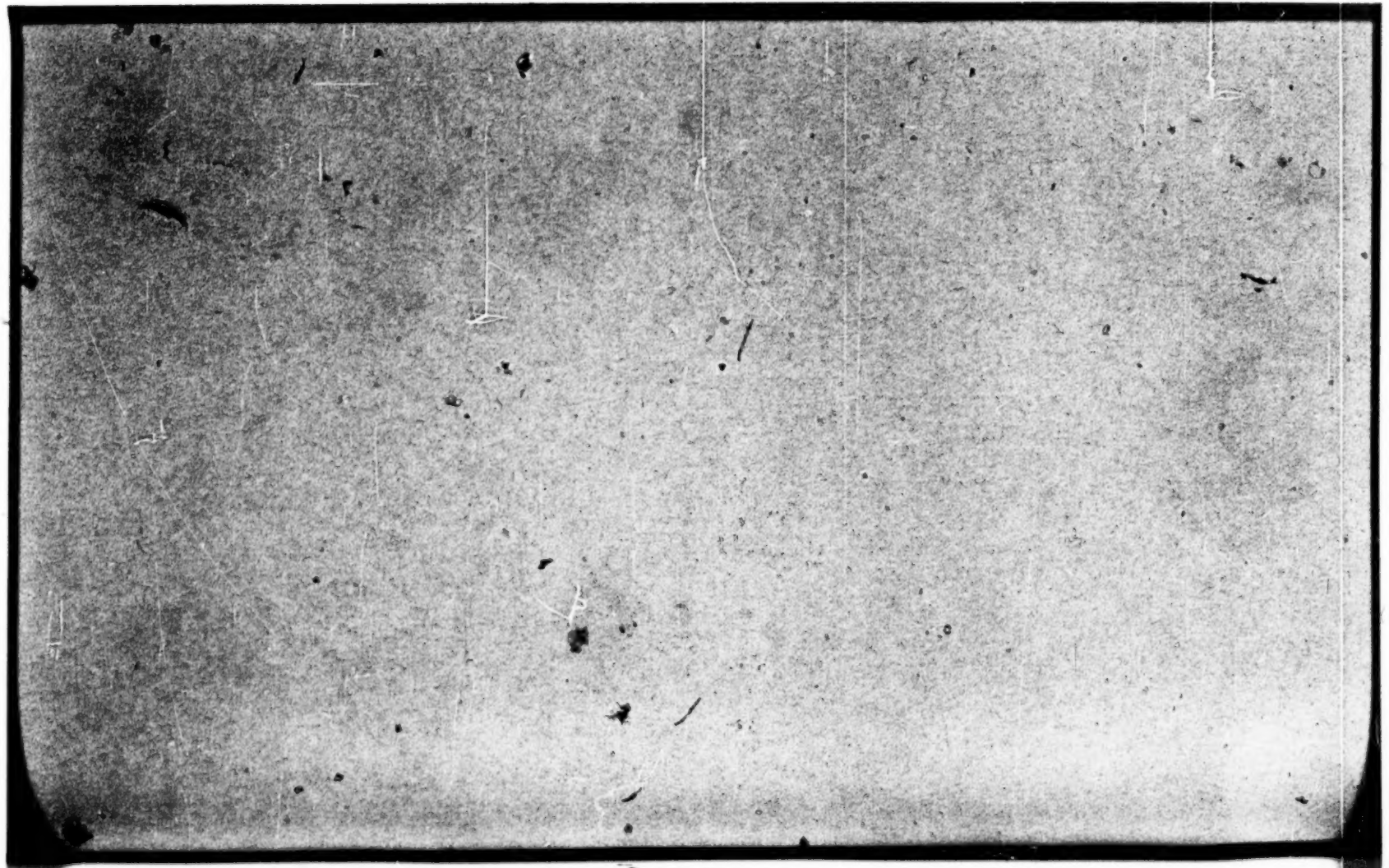
If the Court's decision in that case is sound, it creates an apparent dilemma in the present case. If the Government admits retroactively the validity of the claim, having the opinion of a court of claims as a guide, then it follows that there was no deductible loss in the years 1913, 1914, 1915 and 1916, and the items should be corrected in the returns for these years, and consequently there is no basis for contending that the amount is income in 1920 when the valid claim was reduced to possession.

But, if the Government's denial of the claim was deemed proper, then the amount received pursuant to judgment of the Court of Claims is a gratuity or a voluntary moral act by the United States, by virtue of which the capital invested in the transaction was restored to the taxpayer and as such is not income subject to tax, and of course there would be no retroactive adjustment of prior years.

We respectfully submit that the decision of the lower Court is sound, and that this case is controlled by the decision of this Court in *Bowers* v. *Kerbaugh-Empire Company*, *supra*.

CHARLES D. HAMEL,
RICHARD S. DOYLE,
BRAINARD AVERY,
Counsel for Crossman & Sielcken, in Liquidation, as Amici Curiae.





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SUPREME COURT OF THE UNITED STATES.

No. 31.—October Term, 1930.

David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Sanford & Brooks Company. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[January 5, 1931.]

Mr. Justice Stone delivered the opinion of the Court.

In this case certiorari was granted, 281 U. S. 707, to review a judgment of the Court of Appeals for the Fourth Circuit, 35 F. (2d) 312, reversing an order of the Board of Tax Appeals, 11 B. T. A. 452, which had sustained the action of the Commissioner of Internal Revenue in making a deficiency assessment against respondent for income and profits taxes for the year 1920.

From 1913 to 1915, inclusive, respondent, a Delaware corporation engaged in business for profit, was acting for the Atlantic Dredging Company in carrying out a contract for dredging the Delaware River, entered into by that company with the United States. In making its income tax returns for the years 1913 to 1916, respondent added to gross income for each year the payments made under the contract that year, and deducted its expenses paid that year in performing the contract. The total expenses exceeded the payments received by $176,271.88. The tax returns for 1913, 1915 and 1916 showed net losses. That for 1914 showed net income.

In 1915 work under the contract was abandoned, and in 1916 suit was brought in the Court of Claims to recover for a breach of warranty of the character of the material to be dredged. Judgment for the claimant, 53 Ct. Clms. 490, was affirmed by this Court in 1920. *United States* v. *Atlantic Dredging Co.*, 253 U. S. 1. It held that the recovery was upon the contract and was "compensatory of the cost of the work, of which the government got the benefit." From the total recovery, petitioner received in that year

the sum of $192,577.59, which included the $176,271.88 by which its expenses under the contract had exceeded receipts from it, and accrued interest amounting to $16,305.71. Respondent having failed to include these amounts as gross income in its tax returns for 1920, the Commissioner made the deficiency assessment here involved, based on the addition of both items to gross income for that year.

The Court of Appeals ruled that only the item of interest was properly included, holding, erroneously as the government contends, that the item of $176,271.88 was a return of losses suffered by respondent in earlier years and hence was wrongly assessed as income. Notwithstanding this conclusion, its judgment of reversal and the consequent elimination of this item from gross income for 1920 were made contingent upon the filing by respondent of amended returns for the years 1913 to 1916, from which were to be omitted the deductions of the related items of expenses paid in those years. Respondent insists that as the Sixteenth Amendment and the Revenue Act of 1918, which was in force in 1920, plainly contemplate a tax only on net income or profits, any application of the statute which operates to impose a tax with respect to the present transaction, from which respondent received no profit, cannot be upheld.

If respondent's contention that only gain or profit may be taxed under the Sixteenth Amendment be accepted without qualification, see *Eisner* v. *Macomber*, 252 U. S. 189, *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, the question remains whether the gain or profit which is the subject of the tax may be ascertained, as here, on the basis of fixed accounting periods, or whether, as is pressed upon us, it can only be net profit ascertained on the basis of particular transactions of the taxpayer when they are brought to a conclusion.

All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. Under §§ 230, 232 and 234 (a) of the Revenue Act of 1918, 40 Stat. 1057, respondent was subject to tax upon its annual net income, arrived at by deducting from gross income for each taxable year all the ordinary and necessary expenses paid during that year in carrying on any trade or business, interest

and taxes paid, and losses sustained, during the year. By §§ 233 (a) and 213 (a) gross income "includes . . . income derived from . . . businesses . . . or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." The amount of all such items is required to be included in the gross income for the taxable year in which received by the taxpayer, unless they may be properly accounted for on the accrual basis under § 212 (b). See *United States* v. *Anderson*, 269 U. S. 422; *Aluminum Castings Co.* v. *Routzahn*, No. 7, October Term, 1930, decided November 24, 1930.

That the recovery made by respondent in 1920 was gross income for that year within the meaning of these sections cannot, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures made in performing the contract, still, as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. See *Doyle* v. *Mitchell Brothers Co.*, *supra*, p. 185.

That such receipts from the conduct of a business enterprise are to be included in the taxpayer's return as a part of gross income, regardless of whether the particular transaction results in net profit, sufficiently appears from the quoted words of § 213 (a) and from the character of the deductions allowed. Only by including these items of gross income in the 1920 return would it have been possible to ascertain respondent's net income for the period covered by the return, which is what the statute taxes. The excess of gross income over deductions did not any the less constitute net income for the taxable period because respondent, in an earlier period, suffered net losses in the conduct of its business which were in some measure attributable to expenditures made to produce the net income of the later period.

Bowers v. *Kerbaugh-Empire Co.*, 271 U. S. 170, on which respondent relies, does not support its position. In that case the taxpayer, which had lost, in business, borrowed money, which was to be repaid in German marks, and which was later repaid in de-

preciated currency, had neither made a profit on the transaction, nor received any money or property which could have been made subject to the tax.

But respondent insists that if the sum which it recovered is the income defined by the statute, still it is not income, taxation of which without apportionment is permitted by the Sixteenth Amendment, since the particular transaction from which it was derived did not result in any net gain or profit. But we do not think the amendment is to be so narrowly construed. A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or a loss.

The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis. The computation of income annually as the net result of all transactions within the year was a familiar practice, and taxes upon income so arrived at were not unknown, before the Sixteenth Amendment. See *Bowers* v. *Kerbaugh-Empire Co., supra*, p. 174; *Pacific Insurance Co.* v. *Soule*, 7 Wall. 433; *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S. 601, 630. It is not to be supposed that the amendment did not contemplate that Congress might make income so ascertained the basis of a scheme of taxation such as had been in actual operation within the United States before its adoption. While, conceivably, a different system might be devised by which the tax could be assessed, wholly or in part, on the basis of the finally ascertained results of particular transactions, Congress is not required by the amendment to adopt such a system in preference to the more familiar method, even if it were practicable. It

would not necessarily obviate the kind of inequalities of which respondent complains. If losses from particular transactions were to be set off against gains in others, there would still be the practical necessity of computing the tax on the basis of annual or other fixed taxable periods, which might result in the taxpayer being required to pay a tax on income in one period exceeded by net losses in another.

Under the statutes and regulations in force in 1920, two methods were provided by which, to a limited extent, the expenses of a transaction incurred in one year might be offset by the amounts actually received from it in another. One was by returns on the accrual basis under § 212 (b), which provides that a taxpayer keeping accounts upon any basis other than that of actual receipts and disbursements, unless such basis does not clearly reflect its income, may, subject to regulations of the Commissioner, make its return upon the basis upon which its books are kept. See *United States* v. *Anderson*, and *Aluminum Castings Co.* v. *Routzahn*, *supra*. The other was under Treasury Regulations (Art. 121 of Reg. 33 of Jan. 2, 1918, under the Revenue Acts of 1916 and 1917; Art. 36 of Reg. 45, Apr. 19, 1919, under the Revenue Act of 1918) providing that in reporting the income derived from certain long term contracts, the taxpayer might either report all of the receipts and all of the expenditures made on account of a particular contract in the year in which the work was completed, or report in each year the percentage of the estimated profit corresponding to the percentage of the total estimated expenditures which was made in that year.

The Court of Appeals said that the case of the respondent here fell within the spirit of these regulations. But the court did not hold, nor does respondent assert, that it ever filed returns in compliance either with these regulations, or §212 (b), or otherwise attempted to avail itself of their provisions; nor on this record do any facts appear tending to support the burden, resting on the taxpayer, of establishing that the Commissioner erred in failing to apply them. See *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357, 361.

The assessment was properly made under the statutes. Relief from their alleged burdensome operation which may not be secured under these provisions, can be afforded only by legislation, not by the courts.

Reversed.